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Full contents
Enlarge current cover
Past issues/regional covers
Subscribe

GLOBAL AGENDA
POLITICS THIS WEEK
BUSINESS THIS WEEK
OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

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Print Edition August 11th 2001

The Internet's new borders
Geographical lines and locations are increasingly being imposed on the Internet. Is this good or bad? ... More on this week's lead article

The world this week

Business this week
Politics this week

Leaders

The Internet's new borders

Emerging markets
Crunch time

Japan
Don't go to Yasukuni

Thailand
Reform in reverse

American productivity
Measuring the new economy

The Palestinians
A people under punishment

Letters

On the environment, Italy, Frédéric Bastiat, Bertrand Russell, the EU

Special Report

Geography and the net
Putting it in its place

United States

State budgets
Red ink rising

High-speed rail
Trop peu, trop tard, trop Amtrak

Mr Bush's report card
Not bad, so far

Bill Clinton's real home
It's Arkansas, stupid

Reproductive fantasy
Spin doctors

Lexington
A Republican sex change

The Americas

Central America
Small, vulnerable—and disunited

Bolivia
One-year wonder?

Mexican politics
Love in the PRI

Colombia
Peace recedes

Asia

China
Beidaihe beach blues

Japan
Shrine wars

The Philippines
South Sea trouble

Indonesia
Megawati names her team

Indonesia
The Black Bats strike back

Previous print editions

Aug 4th 2001
Jul 28th 2001
Jul 21st 2001
Jul 14th 2001
Jul 7th 2001

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Business

Semiconductor manufacturers
The great chip glut

Satellite television
Another twist in the tale

Managing Russian companies
A touch of refinement

General Motors and fuel cells
Stationary draw

Microsoft and Windows XP
Nothing if not tenacious

Tesco
Leahy's lead

Face value
Just-in-time people

Finance & Economics

American productivity
A spanner in the productivity miracle

Job cuts at the NYSE
Last orders

American policy towards Argentina
Mixed signals

Insurance in Asia
Unprofitable policies

Export-credit insurance
Insuring Africa

Financial scandals in India
Slaves of the state

European economies
Out of puff

Economics focus
Averse to reality

Science & Technology

Cosmology
Let there be light

Marine biology
A new whale

The periodic table
10-15 seconds of fame

Organ repair
Hearts and minds

Detecting landmines
Ratting on mines

Books & Arts

Contemporary Chinese fiction
From mainland to mainstream

Tudor history
Hooray Henry

America, Canada and Mexico
And gone tomorrow?

Victims of Nazism
Closed accounts, open questions

Advertisement

International

The cost of the intifada
Pain, unequally spread

Israel and the Greek patriarchate
The state backs off

AIDS in Botswana
A new approach

Refugees
Flight into penury

Europe

Macedonia
War or peace?

Italy
The fruits of office

German immigration
Help wanted

France
Watch your wallet

Women in Spain
The usual amount

Charlemagne
Anatoly Kinakh

Britain

Northern Ireland
History or bunk?

BT
Out of the loop

Victorian music halls
Beer and opera

Refugees
Green-eyed in Glasgow

Welsh language
Dim diolch*

The economy
Gloom at the Bank

Foot-and-mouth disease
Muck, brass and politics

Articles flagged with this icon are printed only in the British edition of *The Economist*

Political art
Lumumba's light

Mummification
It's a wrap

Poetry slam
Declamation of independence

A showbiz life
Diamond Lil

Obituary

Eudora Welty

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Economic forecasts

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Small stockmarkets

Emerging-Market Indicators

Overview

Stockmarket turnover

Economy

Financial markets

Advertisement

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Jobs	Business / Consumer	Tenders	Jobs	Tenders	Jobs
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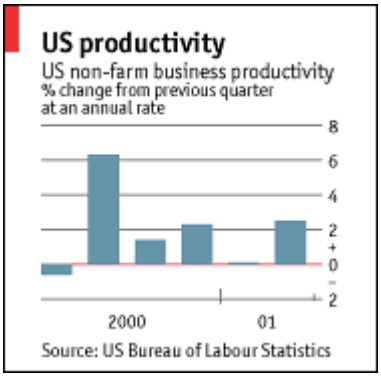
Business this week

Aug 9th 2001
From The Economist print edition

Productivity growth in the **United States** for the three months to June hit 2.5% at an annual rate, exceeding expectations and heavily beating the first-quarter figure of 0.1%. However, revised productivity growth in previous years dampened the claims of “new economy” zealots—average annual growth between 1996 and 2000 was 2.5% rather than 2.8% as previously reported.



German unemployment headed upwards in July for the seventh month in succession; a sign of the country's continuing economic slowdown. Manufacturing orders also slipped in June, heightening fears of a recession in Europe's biggest economy.

As the world's financial policymakers agonised over what to do about **Argentina**, deposits continued to seep out of the country's banking system. In an effort to prevent a wider emerging-market crisis, the IMF offered Brazil a new $15 billion agreement. Argentine officials said they also expected support.

After proof of police violence at the **G8 summit** in Genoa,Italy's government shifted three top policemen sideways. It revealed new worries: about a meeting of NATO defence ministers in Naples in September, and a grand “world food summit” of the Food and Agriculture Organisation, scheduled for Rome in November.

DirecTV action

EchoStar Communications, America's second-largest satellite-TV firm, entered the contest to take over a rival, **DirecTV**, owned by Hughes Electronics, itself a subsidiary of General Motors. EchoStar's $32 billion all-share bid may dislodge a lower offer from News Corp but runs a risk of falling foul of America's antitrust authorities.

Cisco Systems, a network-equipment firm and technology bellwether, revealed that sales had plummeted in the latest quarter by 25% and that it had made a profit of a paltry $7m. It said that the next quarter could be worse still.

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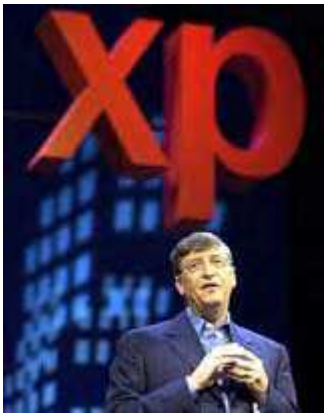

Microsoft asked the United States Supreme Court to reverse the guilty verdict in its long-running antitrust case. At the same time, it asked the appeals court, where the case currently resides, not to send it back to a lower court to decide on remedies. The appeal court had overturned previous remedies but not the verdict. It was suggested that the software giant was stalling to avoid legal difficulties before the launch of its new operating system, Windows XP.

Heavily indebted **British Telecom** was offered £18 billion ($25 billion) for its fixed-line network in Britain from a consortium headed by **WestLB**, a German investment bank. A week earlier, BT dismissed an offer of £8 billion for its local network from an American consortium.

Deutsche Telekom was hammered after a mystery seller put shares worth *euro*1 billion ($880m) on the market. Speculation mounted over both the identity and motive of the vendor.

Mid-air collusion

British Airways revived plans for a transatlantic alliance with American Airlines that failed to take off five years ago. The deal would require antitrust immunity, unlikely to be granted unless the governments of Britain and America can agree on a much delayed “open skies” agreement to liberalise air traffic between the two countries.

Airlines suffered from the slowing world economy. **BA** announced operating profits of £50m ($71m) in the latest quarter, a 50% decline compared with a year ago. **KLM Royal Dutch** announced that it would lay off 500 employees, nearly 2% of the total. **Cathay Pacific s**aid that profits for the first half had plunged 39% to HK$1.3 billion ($166m). Germany's **Lufthansa** announced that it would cut back its long-haul network. However, **Ryanair**, one of the world's biggest budget airlines and the most profitable airline of any size, announced a 21% rise in pre-tax profit for the quarter to *euro*27.4m ($24m) as customers apparently favoured cheaper alternatives.

Buying a beer

Interbrew, a Belgian brewer, announced a deal to swallow **Beck's**, Germany's fourth-largest beer maker, for DM3.5 billion ($1.6 billion); Interbrew recently took an 80% stake in Diebels, a smaller German beer maker. The country's highly fragmented brewing industry looks set for further consolidation.

Unilever, an Anglo-Dutch consumer-goods giant, reported that profits for the latest quarter were up by 52% compared with a year ago, to *euro*900m ($768m). America's **Procter & Gamble**, the world's leading consumer-goods firm, made a quarterly loss of $320m, its first for eight years, as restructuring costs hit the company's balance sheet.

In a heavy blow for **Bayer**, a big German drug company, it was forced to withdraw Baycol, an anti-cholesterol drug. America's Food and Drug Administration said that 31 deaths were linked to the treatment. The company issued a profit warning and its shares plummeted.

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Politics this week

Aug 9th 2001
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Suicide bomb in Jerusalem

A Palestinian suicide bomber blew himself up in a crowded restaurant in **Jerusalem**'s central shopping district. Israeli radio said 18 people were killed and nearly 90 wounded, in the bloodiest bomb attack the city has seen since 1997. The militant group Islamic Jihad claimed responsibility.

See article: A people under punishment

The killing of ten soldiers and anti-Albanian riots in Skopje and elsewhere cast doubt on the credibility of a western peace plan initialled by **Macedonia's** mainly Slav government and ethnic Albanians. It would allow wider use of Albanian as an official language and broaden the police's ethnic make-up.

See article: War or peace?

Delegates to a National Academy of Sciences conference in Washington, DC, said they would press on with pioneering efforts to **clone humans**—despite condemnation from most scientists and politicians.

See article: Spin doctors

Bush holiday

AP

President George Bush began a month-long holiday at his ranch in Crawford, Texas, on a high note, having pushed a patients' bill of rights through the House of Representatives. It will allow Americans to sue their health insurers if care is unfairly denied.

See article: Not bad, so far

George Ryan, the unpopular Republican governor of Illinois, announced he would not seek re-election after all.

Mexico's formerly ruling Institutional Revolutionary Party won a state election for the first time in two years. Its victory in Tabasco gave a boost to the party-leadership ambitions of Roberto Madrazo, a populist former governor of that state.

See article: Love in the PRI

President Andres Pastrana announced that he had suspended peace talks with the ELN, the smaller of **Colombia's** two main guerrilla groups. He accused the guerrillas of obstinacy.

See article: Peace recedes

Hugo Banzer, who has cancer, stepped down as **Bolivia's** president a year before the end of his five-year term. He was replaced by Vice-President Jorge Quiroga, a conservative American-educated technocrat.

See article: One-year wonder?

Real breakthrough?

A big car bomb blamed on the Real IRA wounded several people in west London. In **Northern Ireland**, the Provisional (ie, actual) IRA proposed “a scheme” for putting its weapons beyond further use. A “historical breakthrough”, trumpeted its political wing, Sinn Fein. Just what sort of scheme and when, asked unionists? They got no answers.

See article: History or bunk?

After proof of police violence at the **G8 summit** in Genoa,Italy's government shifted three top policemen sideways. It revealed new worries: about a meeting of NATO defence ministers in Naples in September, and a grand “world food summit” of the Food and Agriculture Organisation, scheduled for Rome in November.

Corsican separatists demanded a general amnesty and the release of around 40 “political prisoners” from French jails as an immediate part of a government plan to bring peace to the island. No, said the government.

Late president

AP

Muhammad Khatami was sworn in for his second term as **Iran's president** several days late after an unsuccessful attempt by his reformist parliament to challenge the Council of Guardians, which had blocked pro-reform laws during his first term.

The **Lebanese army** arrested 150 members, including students and party officials, of two right-wing Christian groups opposed to the Syrian presence in Lebanon.

Some of the worst fighting for years broke out in **Somalia** as rival militias fought for the ports of Kismayo and, in the previously peaceful north-east, Bossaso. A national government formed last year is failing to establish nation-wide rule.

Missile deference

Joseph Biden, head of the American Senate's Foreign Relations Committee, said after talks with China's president, Jiang Zemin, that they had “agreed to disagree” on whether **China** was keeping to its commitments on missile proliferation.

Kim Jong Il, leader of **North Korea**, left Russia promising no new missile tests until at least 2003.

Islamic leaders in **Singapore** ruled that Muslim men may not divorce their wives by sending text messages over their mobile phones. A court in Dubai had recently found the opposite.

In Mindanao, the southern island of **the Philippines**, one guerrilla group signed a ceasefire with the government. But another, the Abu Sayyaf, beheaded ten of its hostages.

See article: South Sea trouble

Afghanistan's **Taliban** arrested eight foreign aid workers for allegedly spreading Christianity. Under a new decree, they will not face the death penalty. But 16 Afghans seized with them could be executed for proselytism.

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The Internet's new borders

Aug 9th 2001
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Geographical lines and locations are increasingly being imposed on the Internet. Is this good or bad?

LONG, long ago in the history of the Internet—way back in February 1996—John Perry Barlow, an Internet activist, published a "Declaration of the Independence of Cyberspace". It was a well-meaning stunt that captured the spirit of the time, when great hopes were pinned on the emerging medium as a force that would encourage freedom and democracy. "Governments of the industrial world," Mr Barlow declared, "on behalf of the future, I ask you of the past to leave us alone. You are not welcome among us. You have no sovereignty where we gather. You have no moral right to rule us nor do you possess any methods of enforcement we have true reason to fear. Cyberspace does not lie within your borders."

Those were the days. At the time, it was widely believed that the Internet would help undermine authoritarian regimes, reduce governments' abilities to levy taxes, and circumvent all kinds of local regulation. The Internet was a parallel universe of pure data, an exciting new frontier where a lawless freedom prevailed. But it now seems that this was simply a glorious illusion. For it turns out that governments do, in fact, have a great deal of sovereignty over cyberspace. The Internet is often perceived as being everywhere yet nowhere, as free-floating as a cloud—but in fact it is subject to geography after all, and therefore to law.

The idea that the Internet was impossible to regulate dates back to when its architecture was far simpler than now. All sorts of new technologies have since been bolted on to the network, to speed up the delivery of content, protect networks from intruders, or target advertising depending on a user's country or city of origin (see article). All of these technologies have mundane commercial uses. But in some cases they have also provided governments with ways to start bringing the Internet under the rule of local laws.

"The diffusion of the Internet does not necessarily spell the demise of authoritarian rule"

The same firewall and filtering technology that is used to protect corporate networks from intrusion is also, for example, used to isolate Internet users in China from the rest of the network. A recent report on the Internet's impact in China by the Carnegie Endowment for International Peace (CEIP), a private think-tank based in Washington, DC, found that the government has been able to limit political discourse online. Chinese citizens are encouraged to get on the Internet, but access to overseas sites is strictly controlled, and what users post online is closely monitored. The banned Falun Gong movement has had its website shut down altogether. By firewalling the whole country, China has been able to stifle the Internet's supposedly democratising influence. "The diffusion of the Internet does not necessarily spell the demise of authoritarian rule," the CEIP report glumly concluded. Similarly, Singapore and Saudi Arabia filter and censor Internet content, and South Korea has banned access to gambling websites. In Iran, it is illegal for children to use the Internet, and access-providers are required to prevent access to immoral or anti-Iranian material. In these countries, local standards apply, even on the Internet.

To American cyber-libertarians, who had hoped that the Internet would spread their free-speech gospel around the world, this is horrifying. Yahoo! is appealing against the French decision, because it sets a precedent that would require websites to filter their content to avoid breaking country-specific laws. It would also have a chilling effect on free speech, since a page posted online in one country might break the laws of another. Enforcing a judgment against the original publisher might not be possible, but EU countries have already agreed to enforce each other's laws under the Brussels Convention, and there are moves afoot to extend this scheme to other countries too, at least in the areas of civil and commercial

law, under the auspices of the Hague Convention.

It is true that filtering and geolocation are not watertight, and can be circumvented by skilled users. Filters and firewalls can be defeated by dialling out to an overseas Internet access-provider; geolocation can be fooled by accessing sites via another computer in another country. E-mail can be encrypted. But while dedicated dissidents will be prepared to go to all this trouble, many Internet users are unable to change their browsers' home pages, let alone resort to these sorts of measures. So it seems unlikely that the libertarian ethos of the Internet will trickle very far down in countries with authoritarian regimes. The upshot is that local laws are already being applied on the Internet. Old-style geographical borders are proving surprisingly resilient.

Getting real

In some ways this is a shame, in others not. It is certainly a pity that the Internet has not turned out to be quite the force for freedom that it once promised to be. But in many ways, the imposition of local rules may be better than the alternatives: no regulation at all, or a single set of rules for the whole world. A complete lack of regulation gives a free hand to cheats and criminals, and expecting countries with different cultural values to agree upon even a set of lowest-common-denominator rules is unrealistic. In some areas, maybe, such as extradition and consumer protection, some countries or groups of countries may be able to agree on common rules. But more controversial matters such as free speech, pornography and gambling are best regulated locally, even if that means some countries imposing laws that cyber-libertarians object to.

Figuring out whose laws apply will not always be easy, and thrashing all of this out will take years. But it will be reassuring for consumers and businesses alike to know that online transactions are governed and protected by laws. The likely outcome is that, like shipping and aviation, the Internet will be subject to a patchwork of overlapping regulations, with local laws that respect local sensibilities, supplemented by higher-level rules governing cross-border transactions and international standards. In that respect, the rules governing the Internet will end up like those governing the physical world. That was only to be expected. Though it is inspiring to think of the Internet as a placeless datasphere, the Internet is part of the real world. Like all frontiers, it was wild for a while, but policemen always show up eventually.

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Emerging markets

Crunch time

Aug 9th 2001
From The Economist print edition

The United States needs to make up its mind about Argentina—and fast

HAS the Bush administration written off Argentina and decided to save Brazil? That was the impression on Wall Street this week after the IMF's decision to offer Brazil a new $15 billion loan package, while merely accelerating $1.2 billion of existing loans for Argentina. Or is the United States, through the IMF, about to ride to the rescue? That was the speculation in Buenos Aires, as Argentine officials suggested negotiations on at least $6 billion of new loans were well advanced.

Embattled Argentines may be exaggerating how close they are to getting help. But who knows? The IMF, and America's Treasury even more so, have been sending hopelessly mixed signals about what support Argentina can expect (see article). Worse, there is no sign that anyone in Washington has a serious strategy either for getting Argentina out of this mess or for dealing with an Argentine collapse. The current formula for avoiding an Argentine default—draconian spending cuts and relatively small amounts of IMF money dribbled out over the next two years—is not going to work.

Decisions, decisions

In the past fortnight Argentina has ensured that it needs to borrow hardly any money until next year, by adopting a painful zero-deficit policy and persuading local banks to swap short-term domestic debt for longer maturities. Despite the government's new gritty determination, the crisis gets ever deeper. Spreads on Argentina's foreign bonds remain close to all-time highs. Worse, Argentines are losing confidence. Bank deposits fell $6.1 billion, or 7%, in July. Foreign-exchange reserves have fallen too. Unless confidence is restored, this slow-motion bank-run will cause a banking crisis, debt default and currency collapse. That means that either someone must provide enough money to restore Argentines' confidence in their financial system, or else a collapse must be assumed and outsiders should concentrate on minimising the consequences.

The choice hinges on whether you believe Argentina's frugal new budget policies offer a lasting solution to its problems. If they do, as Argentina argues, then today's spreads and the loss of confidence are just irrational market behaviour. This in turn suggests that the correct international response is to offer enough financial help—provided fiscal policy stays tight—to increase investors' confidence and reduce interest rates. On this view, the IMF and the United States should say clearly that they will stand behind Buenos Aires with more cash.

An alternative view, which seems more plausible, is that it is too late for tight fiscal policy alone to solve Argentina's problems. Even if the run on deposits is stopped, unpopular and recession-deepening budget cuts will fail to persuade investors that Argentina's economy will grow again. Without growth, the spectre of default remains. If a crisis is unavoidable, the sooner it happens the better, not least for Argentina.

Argentina need not be written off, even if its debt needs to be restructured

Recognising that Argentina needs to restructure its debts does not mean writing the country off. There is a huge difference between a debt restructuring in co-operation with the IMF, supported by official money, and a chaotic meltdown of the sort that Russia went through in August 1998. But even under the best of circumstances this will be hard to manage. Changing the terms of any bond contract will land Argentina in a legal morass. The world's biggest emerging-

market borrower will be cut off from debt markets. Domestic banks, which hold much of the debt, will be in trouble. In the worst case, Argentines could pull out their money, forcing a collapse of the currency. Uncontrolled depreciation of the peso would lead to widespread corporate insolvency and high inflation.

And that's not all. Even with a $15 billion IMF-built firewall across the pampas, Brazil could be in serious trouble if Argentina collapses. Rich-country banks, too, could feel the pain: Europe's banks have an exposure of over $40 billion to Argentina; even America's banks have around $10 billion on the line. Politically, a meltdown in Argentina could have long-term ramifications. Already, voters are getting fed up with liberal economics and open markets.

Engineering a debt restructuring that avoids these risks will be hard, and expensive. To help ensure default does not become a rout, Argentina will need cash from the IMF, and possibly from rich-country governments. Equally important are clear leadership and a single voice from Washington. Argentina will need help in negotiating with creditors and dealing with the plethora of lawsuits that are bound to ensue. And even with leadership and cash, there is no guarantee that a default will not spiral out of control. With the world economy looking wobblier than it has for years, these dangers must be taken seriously. But a coherent if risky strategy seems more promising than no strategy at all. The United States must make a decision about Argentina, and stick with it.

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Japan

Don't go to Yasukuni

Aug 9th 2001
From The Economist print edition

Japan's prime minister should stay away from the Yasukuni shrine

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AP

UNLESS he has a last-minute change of mind, Japan's prime minister, Junichiro Koizumi, will next week ignite a row with China, with South Korea (co-host with Japan of the 2002 football World Cup), with his main coalition partner and with much of his own party, including his foreign minister. He will do this by visiting a shrine dedicated to the country's war dead on August 15th, which is the anniversary of Japan's surrender in the second world war.

Why shouldn't a Japanese prime minister pay his respects to his country's dead? Indeed he should, just as German chancellors should, and do. But German chancellors do not visit places that celebrate the nastier sort of German nationalism, let alone the memory of men such as Hitler, Göring and Himmler. Mr Koizumi, by contrast, wants to go to Yasukuni precisely because it is a symbol of Japanese nationalism, as well as a place to commemorate all Japan's war dead. Why is it so symbolic? To some, at least, because of the spiritual presence there of General Hideki Tojo and a dozen others convicted as "Class A" war criminals in the 1946-48 Tokyo trials. They are not enshrined there lightly, because it is hardly obvious that men executed for war crimes have given their lives for their country. They are there because, in 1978, the shrine's authorities took a deliberate, and secret, decision to admit them.

Since then, the authorities have rejected all appeals to "remove" the war criminals, including proposals from such establishment figures as Hiromu Nonaka, who has served as Japan's cabinet secretary and secretary-general of Mr Koizumi's Liberal Democratic Party. The shrine's authorities are emphatically not in the mainstream of Japanese opinion on this issue. Rather, the shrine—and its adjacent war museum, with its *kaiten* human-guided suicide torpedoes and its *ohka* suicide rocket-bombs—has become a place of veneration for all those who believe that Japan has nothing to apologise for in its conduct of a war that was forced upon it.

Even without the war criminals, Yasukuni would remain controversial. After its foundation in 1869, it served as the pre-eminent shrine of state Shinto, a late 19th-century fusion of an ancient religion with modern absolutist government. State Shinto was abolished (by the Americans) after the war as being widely associated, by Japanese as well as foreigners, with the rise of militarism. An official prime-ministerial visit to Yasukuni, therefore, threatens to erode the separation of state and religion laid down in Japan's constitution.

Even without the war criminals, Yasukuni would remain controversial

With the sole exception of Yasuhiro Nakasone, who went "officially" in 1985 but never dared do so again, Japan's post-war prime ministers have treated the shrine with immense caution, in fear as much of the Japanese as of the foreign backlash. The others who visited it insisted they were doing so in their private capacities. Mr Koizumi rejects that as a fudge, in which, at least, he is right.

Mr Koizumi can still back down, though he has made it hard for himself, and he may well think he needs the support of conservatives on this matter if he is to offend them with his economic reforms (see article). But there are other acceptable, indeed desirable, ways of showing a decent sort of nationalism, such as amending the constitution to allow Japan to play its full part in the world's collective security. And there are other, less controversial places Mr Koizumi could visit to honour Japan's uncriminal war dead. For the sake of Japan, let him go instead to the Chidorigafuchi Memorial Garden.

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Reform in reverse

Aug 9th 2001
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Thailand's prime minister has escaped censure—for unexplained reasons

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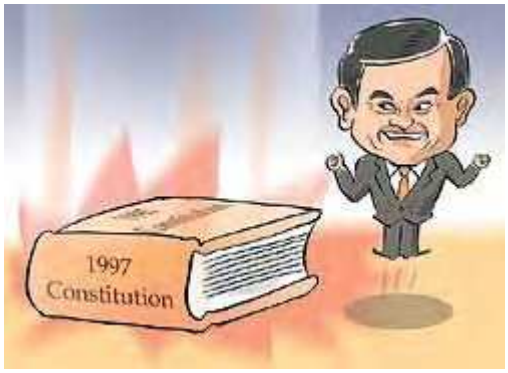

SINCE Asia was first engulfed in financial turmoil in 1997, no country in the region has struggled as hard as Thailand to clean up its murky politics. Once almost a byword for corruption, Thailand emerged as a bit of a trailblazer. Its new constitution set up powerful independent bodies that would hold politicians to greater account, monitoring their attempts to buy votes and, once in power, keeping a close eye on their assets and kicking them out of office if they were found wanting. Optimists liked to claim that good would come of the economic catastrophe, in the shape of cleaner government and an end to the debilitating sickness of cronyism.

On August 3rd, all that went into reverse. On grounds it chose not to reveal, Thailand's Constitutional Court overturned by eight to seven a ruling last year by the new National Counter-Corruption Commission, which had found that the country's richest businessman, Thaksin Shinawatra, had concealed assets worth tens of millions of dollars while serving as deputy prime minister. The commission refused to believe his explanation—that he had not known that his wife, in whose name much of the family fortune was registered, had put large shareholdings in the names of his driver, his maid and a security guard. A few weeks later Mr Thaksin's new Thai Rak Thai party, personally financed by its leader, swept to power in a general election, even though he faced a five-year ban from politics. The Thaksin affair instantly became a test case for the independence of Thailand's new institutions.

In all the eight other appeals it has heard concerning the commission's verdicts, including one decided on the same day as Mr Thaksin's, the court has upheld the counter-corruption body's ruling. Naturally, the court has every right to overturn a decision in any particular case. But it should, at least, give clear reasons if it is to avoid undermining the commission's authority. Reports say the explanation for its unusual failure to hand down a detailed opinion was the absence of consensus among the eight judges about why they decided to exonerate him. Some of them, apparently, only did so on a strange interpretation of a rule that contradicted their decision in at least one earlier case.

Elected, therefore above the law?

What is most worrying about Mr Thaksin is the contempt he has repeatedly shown for the workings of both the commission and the court. Indeed, at first he refused to testify before the commission at all, though he later relented. And even after he had won his case last week, he complained that he found it “strange” that he, “the leader who was voted in by 11m people had to bow to the ruling of the [counter-corruption commission] and the verdict of the Constitutional Court, two organisations composed only of appointed commissioners and judges, whom people did not have a chance to choose”. He has hinted that the laws in question have many “wrong aspects” that need to be changed, and with his strong majority in parliament he will be quite capable of seeing it done.

Most Thais seem happy with the result, however. Mr Thaksin, an energetic telecoms tycoon who launched Thailand's first satellite, has seemed to offer strong government and new hope after years of political weakness and economic pain. He has promoted a few interesting ideas aimed at getting money into the poor rural areas, where it is badly needed, though the results have been patchy. Other promises, such as

cleaning out Thailand's bad debts, have hardly been dealt with at all.

In the longer term, Mr Thaksin's lack of enthusiasm for political reform is likely to cost Thailand dear. The promise that the country's relatively superior democracy would promote a greater respect for the rule of law and a decline in corruption has been one of the main factors keeping investors interested. Without that, its attractions may come to seem limited: Thailand lacks the ultra-cheap workforce of Vietnam, the language skills of the Philippines or the relatively efficient bureaucracy and educated workforce of Malaysia. The comparison with Malaysia is particularly apt: for a long time, Malaysians were happy to accept strong if unaccountable government from Mahathir Mohamad in the interests of economic progress. Only in the past few years has it become apparent how badly he has damaged the political fabric of his country.

The stockmarket in Bangkok seemed to sense something like this in Mr Thaksin's case: after rising 4.2% on the first news of the judgment—thanks largely to rises in Mr Thaksin's own Shin Corp and associated companies—it promptly fell back again. After all, Mr Thaksin's main measure to help the exchange, which urgently needs much better supervision and tighter disclosure rules, has been to propose putting Thailand's clocks forward an hour, to match those in Hong Kong and Singapore. It will take a lot more than that.

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American productivity

Measuring the new economy

Aug 9th 2001
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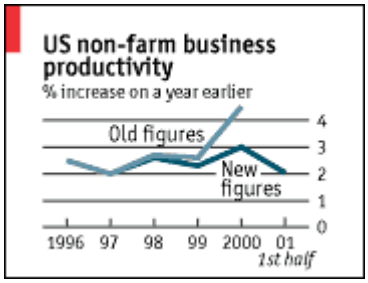
The miracle of the late 1990s was not quite so miraculous



IT IS daunting to consider just how much turns on the question of American productivity. Stockmarket valuations, dizzy even now by historical standards; global financial stability; the outlook for living standards not just in the United States but worldwide; the long-term prospects for combining low inflation and high employment—all these and more depend on whether growth in American productivity really did shift on to a new and faster track, as was widely supposed, during the late 1990s. Over the past year many of the claims of the new economy have been exposed as false: the notion that the business cycle was dead, that spending on information technology was recession-proof, that classical methods of valuing shares were henceforth irrelevant, and so forth. Now, however, the most important pillar of the new economy has been if not demolished at least badly dented.

Headlines this week announced that America's productivity growth had “surged” in the second quarter—proof, it was argued between sighs of relief, that the new economy exists after all. Look closer. The “surge” was an increase from growth of 0.1% (annualised) in the first quarter to 2.5% (annualised) in the second. These quarterly figures are notoriously volatile; actually, growth in productivity slowed from 2.5% in the year to the first quarter to 1.6% in the year to the second. More important, earlier figures, wildly celebrated when first reported, have now been revised. They reveal that average productivity growth in 1999 and 2000—the very period when most American economists started to believe in the new economy—was 2.6%, not 3.4%. Average productivity growth over the past five years has been trimmed to 2.5% from 2.8%.

Some of that 2.5% was “cyclical”, a temporary boost due to the booming economy. In addition, much of the rise came from an extraordinary spurt of investment in IT. Spending on IT has now collapsed and few expect it to grow so fast in future. Adding this up, the best guess is that America's long-term rate of productivity growth is now around 2% (see article).

Inflated expectations

This is still a change worth celebrating. Productivity growth of 2% is much better than the average of 1.4% seen during the previous two decades. It is enough to double incomes every 35 years instead of every 50. It is faster than the productivity growth of 1.5% a year experienced during the first industrial revolution. It is not far short of the 2.3% average witnessed during the ten years to 1929, the early era of electricity and cars. All of which goes to show how inflated expectations had become—because, good as it may be, 2% is way below the estimate of 3% believed by Alan Greenspan and most other American economists at the start of this year. After adding in labour-force growth of around 1% a year, America's long-term potential growth rate in real GDP is probably 3% a year. Hopes that growth in output could persist at 4% a year or more now look unwarranted. Given that policy has been based upon them, they were also irresponsible.

The figures will most likely be revised again—maybe up or down. Optimists are also right to point out that the full benefits of IT investment have yet to show up. Even so, the new numbers raise pointed questions about what many companies and stockmarket investors have been up to. The belief that America had shifted to a much faster rate of growth was used to justify not just share prices but also very heavy corporate borrowing. If future growth proves slower than expected, albeit faster than before, then some of these decisions by

The new numbers raise pointed questions about yesterday's heavy corporate borrowing

investors and firms will start to look dangerous.

Among other things, faster productivity growth was supposed to mean fatter profits, which would encourage firms to invest more and so boost future productivity in a lovely virtuous circle. But profits have also been revised down. According to the old numbers, total company profits amounted to 10% of GDP in the first quarter of this year. The revised figures have cut this to 8% of GDP—down from 12% in 1997 and the lowest since 1992. Much investment in IT has been less profitable than had been thought, making companies' borrowing look even less wise. Equity investors' punt on perpetually rising profits as a share of GDP now looks more ridiculous than ever.

New-economy fanatics can tell themselves, rightly, that America's long-term prospects, and the world's, look much better than they did five years ago. That is fine. For the shorter term, though, they may regret that they bet so much and borrowed so much not on a solid, plausible improvement, but on a miracle that now turns out not to have happened.

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The Palestinians

A people under punishment

Aug 9th 2001
From The Economist print edition

Will economic misery make the Palestinians give up the intifada? Unlikely

Get article background

EPA

SURVIVING under occupation for 30 years and more, the Palestinians concentrated on remaining an integrated people. Although successive Israeli governments, hoping that they could somehow be dispersed or absorbed, discouraged independent economic activity in favour of their employment as unskilled labour in Israel, they managed pretty well. Their current uprising against the occupation could be their undoing.

The humanitarian crisis in the West Bank and Gaza should not be compared to the sharper distress in, say, Congo. The Palestinians are relatively fortunate: the world cares about their region, and the UN agency that has looked after their refugees since Israel's establishment averts starvation. Even so, the ten-month-old *intifada* has condemned over half of them to great poverty (see article). Worse, the fighting, and Israel's methods of retaliation, are damaging the gritty strands that bind the people together, leaving the stage clearer for ever bloodier and more barren violence.

Israel justifies its economic measures on security grounds. This seems reasonable when applied to the ban on most Palestinian workers in Israel, devastating as that ban is. Under threat from terrorist bombs, it is natural that the government should try to build a wall between Israel proper and the Palestinian territories. But, of course, the protection does not work as it should: bombers still slip across the border while peaceable labourers, with no work at home, are forced to see their families clutch at emergency food relief.

Justifying the “internal closure”—that within the Palestinian territories—on security grounds is harder. The roads out of every town in the West Bank, and just about every village, are now blocked by army checkpoints, earth ramparts or deep ditches, the inhabitants shut in, barred from everyday contact with their fellows and often from basic services, including medical ones. The reason given is the protection of the deliberately scattered Israeli settlements. Since Palestinian militants have declared settlers, together with soldiers, to be legitimate targets, the Israeli government protects them with roads and buffer zones, where Palestinians are forbidden and their houses and farms sometimes demolished.

Israel's restrictions do not stop people of ill-intent

In fact, every able-bodied Palestinian will find a dirt track out of his village, though the journey will be grinding and take hours rather than minutes. The restrictions do not stop people of ill-intent. Hence the conclusion that most of the pettier regulations are punitive, punishing the Palestinians for turning down Israel's best offer (though there is beginning to be some revisionist thinking on that) and for rebelling against occupation. Do the Israelis hope that if life is made truly miserable for them, in every way, the Palestinians will eventually abandon the *intifada* and settle for the little they can get now?

If so, it would fit with the long-held theories of Israel's prime minister: create the situation on the ground that suits you, and force your adversary into accepting it. Ariel Sharon became known to the Palestinians in the early 1970s when he was in charge of pacifying the rebellious Gazan refugee camps. He battered the rebels, eliminating their leaders, driving great roads (“Sharon boulevards”) through demolished areas, setting up army bases in the hearts of the camps. The pacification worked, for a time: the camps were calmly wretched for most of the next decade. But after that came the first *intifada*—and the

emergence of militant Islam.

Can Mr Sharon repeat this policy on a wider scale? He is hitting the people hard where it hurts them most, destroying their frail economy, straining their social bonds and undermining their political leadership. But success still seems improbable. The mood is too volatile and too angry: with over 530 Palestinians dead, and over 130 Israelis, the atmosphere reeks of blood-revenge, not submission. If there were a realistic hope of progress towards a decent political arrangement, the punished Palestinians might decide that enough was enough. But there is nothing on offer except an end to the punishment, and that, almost certainly, is not good enough.

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Letters

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From The Economist print edition

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Bonn chance

SIR – Your leader on the deal struck in Bonn ("Kyoto rescued?", July 28th) is unduly pessimistic, and misses the point of the Kyoto Protocol. Its aim was never to achieve deep emission reductions in itself. Rather, by capping emissions for industrialised countries, it makes reductions in greenhouse-gas emissions an integral part of decision making for individuals, companies and policymakers. To be sure, the absence of America from the agreement weakens it, but it is far from a death blow.

Legislation in California to reduce local air pollution is widely regarded as the driving force behind the current huge investment in developing fuel cells for cars. In the medium term, these are expected to have a profound impact on pollution from transport. Manufacturers did not have to wait until the rest of the world had adopted similar legislation before taking the hint. Similarly, Kyoto gives an incentive to companies and governments to find innovative ways to cut emissions while minimising costs and harnessing other benefits, such as improved air quality and reduced dependence on fuel imports. The markets of Europe, Japan, Canada and others should provide more than enough encouragement for large leaps forward in emission-reduction techniques.

Rob Bradley
Climate Network Europe
Brussels

Central Italy

SIR – In your article on the aftermath of the G8 summit, you tell us that the culture of the Italian left is largely against the market and capitalism, and so against America ("Picking up the pieces", July 28th). In fact, the left governed in Italy (however we judge what they have done) up until three months ago, and it is still in charge in many local institutions. Its policy has been anything but hostile to the market, capitalism, etc—as the far-left parties complained. The leaders of today's centre left are the same as in past years; and the " newcomers" (such as Francesco Rutelli) are even more centre-oriented and moderate than the previous ones.

Alessandro Blasimme
Rome

Bring back Bastiat

SIR – Thank you for the reminder of Frédéric Bastiat's petition against the sun's unfair competition with French candle makers (Economics focus, July 21st). Would that some French satirist could do a demolition job on the Common Agricultural Policy or an American Bastiat existed to expose the fallacy of the demand for protection of the country's steel firms. Free trade is always a radical proposal, which is why conservatives (with a big and small c) have difficulty with the idea.

At the same time that Bastiat was writing in France, Ebenezer Elliot was writing his Corn Law rhymes in South Yorkshire. He demolished with wit the 19th century Tory ideology that Britain should be protected from exposure to what the rest of the world could offer. He was equally cool on fake egalitarianism:

What is a Communist?
One who hath yearnings
For equal division of unequal earnings.
Idler or bungler, or both, he is willing
To fork out his copper and pocket a shilling.
He is forever willing
To take your pound and give you his shilling.

In the unrelenting struggle against protectionism (or to use its current modish name, anti-globalisation), as well as the struggle against isolationism, the wit of a pamphleteer such as Bastiat or the imagery of a poet the like of Elliot are worth a million ponderous editorials or earnest speeches.

Denis MacShane MP
Rotherham, South Yorkshire

SIR – Bastiat may not have been as innovative as you suggest. There is an historical account predating his essay petitioning parliament on behalf of candle makers by about 1,000 years in which a Chinese jester makes fun of a governor's benighted economics. When Li Maozhen (856-924) established an oil monopoly to raise income in the poor area he oversaw, he forbade people to use torches so that more profit could be made from the sale of oil. Mocking this, a jester recommended that moonlight also be prohibited so that the need for oil would be greater still. He got a laugh out of Li but did not manage to make him see the light.

Beatrice Otto
London

Russell's nuclear response

SIR – Lord Lawson (Letters, August 4th) is not alone in believing that Bertrand Russell advocated a pre-emptive strike against the Soviet Union in his 1948 speech at Westminster School: the *Daily Worker* headlined its report “Earl Russell calls for atom war.” Russell himself denied this interpretation in letters to the press immediately after the talk and was apt to blame a communist reporter in the audience for putting the story about for political ends. A transcript of the talk reveals that what he advocated was not a pre-emptive strike but “the line of policy which the western nations are now pursuing”, namely, “to make it obvious to the Russians that they can't make war successfully.”

The real trouble, however, came in reply to a question about the fate of Britain in a nuclear war. Russell said there were three alternatives, “*if the present aggressive Russian policy was persisted in*”, (emphasis in the original) “:(a) war with Russia before she has the atomic bombs, ending fairly swiftly and inevitably in a western victory; (b) war with Russia after she has the atomic bombs, ending again in western victory, but after frightful carnage, destruction, and suffering; (c) submission. ” He made it clear that he regarded each alternative as more catastrophic than the one before. But he did not advocate immediate nuclear war with Russia, because he obviously hoped that “the line of policy” which the western nations were pursuing would deter “the present aggressive Russian policy.” I cannot say I approve of the policy Russell did advocate on this occasion, but (press reports to the contrary notwithstanding) it clearly fell short of a pre-emptive nuclear strike. All the relevant texts will eventually be published in “The Collected Papers of Bertrand Russell”.

Nicholas Griffin
McMaster University,
Hamilton, Canada

The Union gap

SIR – So, Romano Prodi “laments the gap between politicians and citizens” in the EU and cites the Irish referendum as an example (“Heart attack? Here's an aspirin”, July 28th). Kafka would be delighted. An unelected politician bewails the vote of a democratic country, but refuses to do the one thing that would immediately give legitimacy to his position and guarantee that citizens would reconnect with the EU: accept the referendum result.

James Noble
Oxford

SIR – Your article on the European Commission's quest for public understanding was jokingly headlined “Heart attack? Here's an aspirin”. Aspirin is in fact the front-line anticoagulant used to prevent occurrences of coronary thrombosis. Intercontinental air travellers worried about deep-vein thrombosis should also consider taking aspirin after supper for three nights before travelling—and should remember not to pick up a souvenir in a tattoo parlour.

Newell White
Norwich

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Geography and the net

Putting it in its place

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The Internet is perceived as being everywhere, all at once. But geography matters in the networked world, and now more than ever

BREWSTER KAHLE unlocks the cellar door of a wooden building in San Francisco's Presidio Park. He steps inside, turns on the fluorescent lights to reveal a solid black wall of humming computers, and throws out his arm theatrically. “This”, he says, “is the web.” It is a seductive idea, but the web isn't really housed in a single San Francisco basement. Mr Kahle's racks of computers merely store archived copies of many of its pages which Alexa, his company, analyses to spot trends in usage. The real Internet, in contrast, is widely perceived as being everywhere, yet nowhere in particular. It is often likened to a cloud.

This perception has prompted much talk of the Internet's ability to cross borders, break down barriers and destroy distance. On the face of it, the Internet appears to make geography obsolete. But the reality is rather more complicated. If you want a high-speed digital-subscriber line (DSL) connection, for example, geographical proximity to a telephone exchange is vital, because DSL only works over relatively short distances. Similarly, go to retrieve a large software update from an online file library, and you will probably be presented with a choice of countries from which to download it; choosing a nearby country will usually result in a faster transfer. And while running an e-business from a mountain-top sounds great, it is impractical without a fast connection or a reliable source of electricity. The supposedly seamless Internet is, in other words, constrained by the realities of geography. According to Martin Dodge of University College London, who is an expert on Internet geography, “the idea that the Internet liberates you from geography is a myth”.

What's more, just as there are situations where the Internet's physical geography is all too visible when it ought to be invisible, the opposite is also true. There is growing demand for the ability to determine the geographical locations of individual Internet users, in order to enforce the laws of a particular jurisdiction, target advertising, or ensure that a website pops up in the right language. These two separate challenges have spawned the development of clever tricks to obscure the physical location of data, and to determine the physical location of users—neither of which would be needed if the Internet truly meant the end of the tyranny of geography.

Down on the farm

To see just how little the Internet resembles a cloud, it is worth taking a look at where the Internet actually is. The answer, in short, is in cities. This is partly a historical accident, says Anthony Townsend, an urban planner at the Taub Urban Research Centre at New York University. He points out that the Internet's fibre-optic cables often piggyback on old infrastructure where a right-of-way has already been established: they are laid alongside railways and roads, or inside sewers. (Engineers installing fibre-optic

cables in a New York building recently unearthed a set of pneumatic tubes, along which telegrams and mail used to be sent in the 19th century.) Building the Internet on top of existing infrastructure in this way merely reinforces real-world geography. Just as cities are often railway and shipping hubs, they are also the logical places to put network hubs and servers, the powerful computers that store and distribute data.

This has led to the rise of “server farms”, also known as data centres or web hotels—vast warehouses that provide floorspace, power and network connectivity for large numbers of computers, and which are located predominantly in urban areas. A typical example can be found in Santa Clara, just off California's Highway 101. It is run by Exodus Communications, a web-hosting firm which has nine server farms in Silicon Valley and another 35 around the world. From the outside, the farm is a deliberately nondescript building. A sophisticated security system, with hand scanners and video cameras, keeps out unauthorised visitors. Inside, the building resembles a jail, rather than a farm: it is packed with row upon row of computers in locked metal cages, their fans whirring and lights flashing. The air is filled with the deafening hum of air-conditioning. There are no windows and few people, and the lights are triggered by motion sensors, keeping unvisited parts of the farm in darkness. Exodus's customers house their computers inside the metal cages, which are supplied with power and network connections. Most of the world's biggest websites live in buildings like this; Exodus hosts 49 of the top 100.

As if to emphasise how physical constraints apply even to virtual spaces, server farms are still rented by the good old-fashioned square foot. According to figures published in April by Salomon Smith Barney, worldwide server-farm capacity is growing by 50% annually, and will reach 22m square feet by the end of 2001, despite the demise of the dotcoms. Cage space turns out to have other uses, too: boastful corporate logos hang from many cages, and some firms have posted job advertisements in the hope of poaching technical staff from rivals.

The signs are that the storage of information is going to become even more physically concentrated. One reason is the growth of “managed hosting” where, instead of renting space on a farm for their own servers, firms rent the computing capacity along with the power and network connectivity. In short, they simply hand over their data, and leave running the servers to the hosting company. As a result, there is no longer any need for customers to visit farms, so they need not be located in metropolitan areas, where space is limited and expensive. They can be anywhere, provided enough power and bandwidth are available.

In practice the constraint is power. A single server farm can consume as much power as a small airport, or four large hospitals. As a result, says Jon Feiber of Mohr Davidow Ventures, a venture-capital firm, the logical thing to do is to build out-of-town server farms with their own power stations. Such farms, he suggests, could be very large indeed: perhaps a dozen would be enough for the whole of the United States. Just such a facility, with a 24MW gas-fired power station, is being built just outside London by iXguardian, a British computer-services firm. It will be the largest server farm in Europe.

The combination of managed hosting and dedicated power stations means that data will be increasingly concentrated in large farms. The rise of wireless devices will drive this trend too: instead of storing data internally, such devices will store information on the network and access it when needed. But users wishing to access their data will still be spread out around the world. So centralisation will drive demand for technology that can smooth out the Internet's geographical lumpiness and speed the delivery of data; in short, technology to obscure the physical location of Internet content from its users.

First, hide the data

One way to do this is to store copies of popular lumps of content in data caches sprinkled around the world. The leader in this field, with over 11,000 caching servers in 62 countries, is Akamai, a firm based in Cambridge, Massachusetts. The geographical distribution of Akamai's infrastructure is strikingly different from that of Exodus. Broadly speaking, Akamai needs servers near the consumers of content, whereas Exodus puts its farms near the suppliers of content. Accordingly, Exodus has farms in North America, Europe, Australia and Japan, but not in Africa or South America. Akamai, on the other hand, has servers pretty much everywhere.

Akamai's customers, which include CNN and Yahoo!, are content providers who are prepared to pay to ensure that users around the world are able to access their sites smoothly and quickly. Normally, when you visit a web server, a description of the page you have requested is delivered across the network. This consists of the page's text, plus references to any graphics (or sound or film clips) associated with it.

These items are then requested by your web browser and delivered across the network. Finally, the browser assembles all the components and displays the page. The problem is that while the text can be delivered quickly, the “heavy” items (such as graphics and video) are much larger and take longer to arrive. It is these items which Akamai can help to deliver more quickly.

It works like this. You request a web page in the usual way, and the page description is delivered. But the references to the page's “heavy” items are modified to fool your web browser into requesting those items from Akamai, rather than from the original web server. Taking account of your location on the network, and given the prevailing traffic conditions, Akamai then delivers the heavy items from the nearest available cache, and the page pops up much more quickly. By monitoring the demand for each item, and making more copies available in its caches when demand rises, and fewer when demand falls, Akamai's network can help to smooth out huge fluctuations in traffic. A further benefit is that the customer's web server does not have to deliver the heavy items, which reduces the load on it dramatically and makes it less likely to collapse when faced with a sudden surge of visitors.

A number of firms have followed in Akamai's footsteps by moving content to the “edges” of the Internet. But there are several other ways to speed up content delivery. One alternative approach is being taken by the Content Bridge Alliance, a group led by a California software firm called Inktomi, whose other members include AOL and Exodus. Rather than setting up a network of thousands of caches, as Akamai has done, the Content Bridge Alliance's plan is to connect existing networks and farms together more efficiently in order to speed the flow of traffic. Yet another approach is being taken by Kontiki, a firm launched this week by veterans of Netscape. It is one of several start-ups that plan to combine Akamai's approach with that of Napster, the infamous music-swapping service. Essentially, users' own computers will be used as caches, so that recently accessed content can be delivered quickly when needed to other users nearby on the network.

Now, find the users

In parallel with all this effort to obscure the physical location of data on the Internet, there is growing interest in determining the location of its users. Laws and tax regimes are based on geography, not network topology; online merchants, for example, may be allowed to sell some products in some countries but not others. The growth in interest in “geolocation” services, which attempt to pinpoint Internet users' locations based on their network addresses, also signals the realisation that traditional marketing techniques, based on geography, can be applied online too. Marie Alexander of Quova, a Silicon Valley geolocation firm, points out that goods and services exist in physical locations, and marketing is traditionally done on a geographical basis. Rather than messing around with fiddly (and privacy-invading) one-to-one marketing, she says, many firms are instead sticking with the old geographical approach, but taking it online. Thus different visitors to a website may be offered different products or special offers, depending on what is available nearby.

Quova's geolocation service, called GeoPoint, is based on a continually updated database that links Internet Protocol (IP) addresses to countries, cities and even postcodes. If you visit a website that is equipped with GeoPoint software, your IP address is relayed to Quova's servers, which look up your geographical location. This information is then used by the website to modify the page's content based on your physical location. Quova claims to be able to identify web users' country of origin with 98% accuracy, and their city of origin (at least for users in the United States) 85% of the time. Other firms, including Akamai, Digital Envoy, InfoSplit and NetGeo, offer similar services.

Once the user's location is known, existing demographic databases, which have been honed over the years to reveal what kinds of people live where, can be brought into play. But although targeted advertising is the most obvious application for geolocation, it has many other uses. It can, for example, be used to determine the right language in which to present a multilingual website. E-commerce vendors and auction houses can use geolocation to prevent the sale of goods that are illegal in certain countries; online casinos can prevent users from countries where online gambling has been outlawed from gaining access; rights-management policies for music or video broadcasts, which tend to be based on geographical territories, can also be enforced. The pharmaceutical and financial-services industries, says Ms Alexander, which are subject to strict national regulation, can be confident that by offering goods and services for sale online they are staying within the law. Borders, she notes, are returning to the Internet.

Interest in geolocation soared after last November's ruling by a French judge requiring Yahoo!, an Internet portal, to ban the auction and sale of Nazi memorabilia over the Internet to users in France. The ruling was significant because it covered sales to French users even from Yahoo!'s websites located in

other countries. The implication is that to avoid breaking French law, websites around the world where such items are sold must prevent French users from gaining access—and geolocation technology allows them to do just that. Of course, the technology is far from perfect; a panel of experts, including Vinton Cerf, the networking guru who is known as the “father of the Internet”, advised the judge that determining an individual user's country of origin was unlikely to be possible more than 90% of the time. But all borders are slightly porous, and the French judge decided that 90% was good enough.

Rather than adopt geolocation technology, Yahoo! responded by banning the auction of Nazi items across all of its sites, and says it has no plans to reinstate them. But it is challenging the ruling in order to avoid having other such restrictions placed on its content by other jurisdictions. The company, which is based in America, has asked a federal court in San Jose to declare the French ruling unenforceable in the United States. (Ironically, Yahoo! said last month that it would begin using Akamai's geolocation technology to target advertising and other content.)

Critics of the French ruling agree that it would set a dangerous precedent, by allowing one country to interfere with freedom of speech across the entire Internet. “If every jurisdiction in the world insisted on some form of filtering for its particular geographic territory, the web would stop functioning,” Mr Cerf declared. Stanton McCandlish of the Electronic Frontier Foundation, a pressure group, says he expects other governments to adopt geolocation and other similar techniques to balkanise the Internet in coming years. But he notes that geolocation is merely the latest example in a growing trend to impose local controls on the Internet. China, for example, already filters all Internet traffic flowing into and out of the country in order to prevent its citizens from accessing particular websites.

At the same time, the French ruling is regarded in some quarters as a logical and pragmatic way forward for Internet regulation; in the real world, after all, multinational firms are used to operating under different laws in different countries. According to Lawrence Lessig, a Stanford law professor, “the notion that governments can't regulate hangs upon a particular architecture of the Net.” As the Internet's architecture changes and becomes more complex, with the addition of services like filtering and geolocation, the idea that the Internet is beyond the reach of local laws and government regulation looks less and less tenable.

The revenge of geography

So much for the death of geography. And determining the location of Internet users seems likely to become even more commonplace, and even more accurate, with the rise of wireless Internet devices such as smart phones. Already, the first “location-based services” have been launched, capable of sending text messages to mobile-phone users in particular network cells. More accurate positioning will be possible in future using a number of other techniques, such as the satellite-based Global Positioning System. Advertisers are rubbing their hands at the prospect of being able to send precisely targeted offers to people near particular shops, or inside a sports arena, though privacy concerns may yet scupper their plans. Less annoyingly, users of smart phones may choose to call up location-specific information, such as maps or traffic updates, or to locate a nearby restaurant. According to a recent estimate from Analysys, a telecoms consultancy, global revenues from location-based services will reach $18 billion by 2006—a figure that is regarded as conservative by many in the industry.

Mr Townsend notes that cities are, in a sense, vast information storage and retrieval systems, in which different districts and neighbourhoods are organised by activity or social group. A mobile Internet device, he suggests, will thus become a convenient way to probe local information and services. Location will, in effect, be used as a search parameter, to narrow down the information presented to the user. Mobile devices, he says, “reassert geography on the Internet.”

At the moment, Internet users navigate a largely placeless datasphere. But in future they will want location-specific information and access to their personal data, wherever they are—and wherever it is. This will be tricky to pull off, and impossible without taking geography explicitly into account. It is undoubtedly true that the Internet means that the distance between two points on the network is no longer terribly important. But where those points are still matters very much. Distance is dying; but geography, it seems, is still alive and kicking.

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About sponsorship

State budgets

Red ink rising

Aug 9th 2001 | PROVIDENCE, RHODE ISLAND
From The Economist print edition

The states are in financial trouble again; and it's their fault

"NORTH CAROLINA", says Richard Moore, the state's treasurer, "is a microcosm for the federal situation." Which is not good. Tax revenues in the state are $500m lower than budgeted for. Spending is higher, and the state has not yet passed a 2001 budget, missing the deadline by months. Instead, the governor has declared a fiscal emergency, cutting proposed spending, suspending some payments, and transferring all government surpluses to one general fund. Moody's, the rating agency, has the triple-A rated state on "negative outlook".

Welcome to the forgotten part of America's fiscal system. Budget-watchers focus most of their attention on the federal behemoth; but its component states spend much more than is generally realised—and they are in trouble. "This year isn't good and I'm afraid next year may be worse," says Scott Pattison, the new chief executive of the National Association of State Budget Officers, as he peers down into the extravagantly marbled halls of the Vanderbilt family retreat in Rhode Island, where the state governors have come to dance the evening away at their annual meeting.

The states spend almost $1 trillion a year (see chart 1), half the amount spent by the federal government. During the 1980s, the states' budget surpluses helped to offset vast federal deficits. Their budgets are also useful barometers. They tend to be more sensitive to downturns. And because all states except Vermont are legally required to run balanced budgets, state politicians face spending trade-offs as soon as revenues dip, so political rows appear earlier.

The barometer is signalling "Rain". In fiscal 2001 (which ended on June 30th), state revenues increased by 4.5% in nominal terms. This sounds respectable but isn't. The rise was half what it had been the year before and was the slowest since 1993—a time when the budget position of the states was widely deemed the worst since the 1930s. And the 4.5% rise masks big variations. High oil prices helped energy-rich states (Alaska, Oklahoma, New Mexico) raise revenues by more than 10%. But the take fell in Michigan and Wisconsin and was flat in several other industrial states, confirming the severity of the recession

in manufacturing.

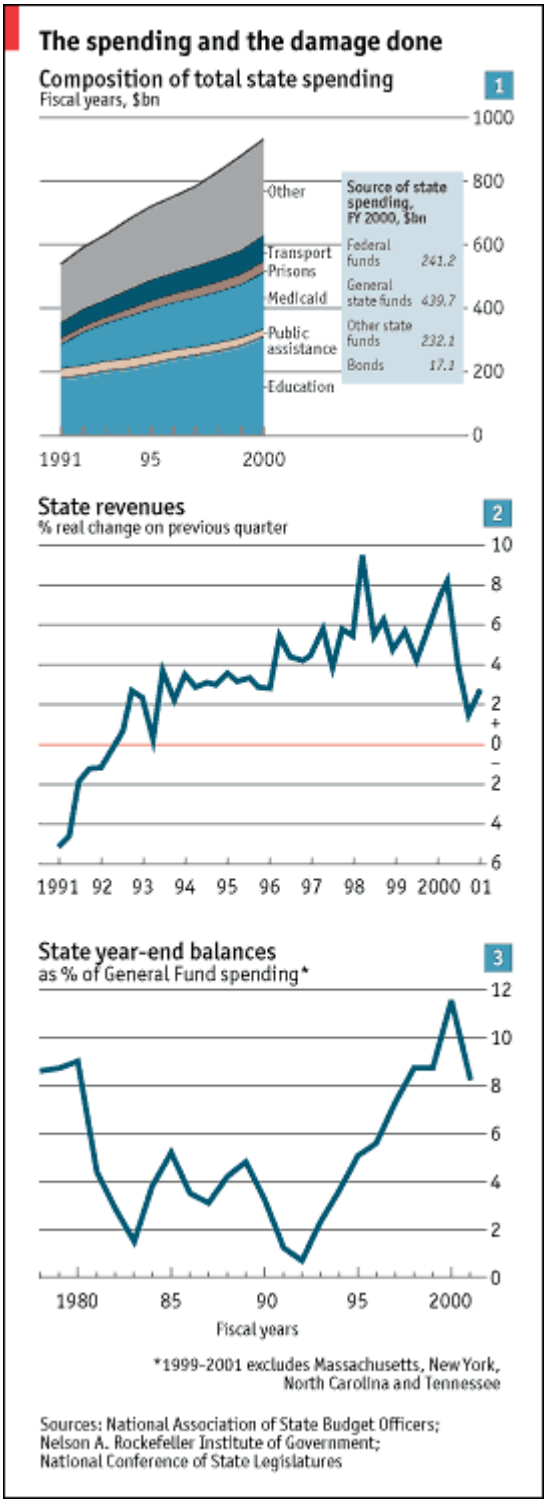
Moreover, if you adjust the overall rise for inflation and legislated tax changes to get at underlying revenue growth, the picture is even grimmer. According to the Rockefeller Institute of Government at the State University of New York in Albany, the adjusted real increase was just over 2% in the past six months (see chart 2). And that was helped by unexpectedly strong growth in personal income taxes, buoyed by capital gains (which are taxed as income). As the full consequences of the stockmarket's slump feeds through, income taxes, which account for more than half of some states' revenues, will slow further next year and could even fall.

States get around a third of their revenues from sales taxes. This should have helped because consumption is the bit of the economy that has held up best so far. But in the first quarter of this year the year-on-year growth in sales taxes was a nominal 3.3%, compared with an 8.2% jump in the first three months of 2000. Adjusted for inflation and tax changes, the rise was a miserable 0.3% and sales taxes may fall a little in fiscal 2002. But even that would be better than corporate income taxes. These slumped nearly 10% in the past six months, the biggest drop since 1983.

States cannot, however, blame the slowing economy for all their woes. During the heady days of the 1990s, they launched programmes that look unaffordable now. Between 1990 and 1998, the real cumulative growth was 30%—about $630 more per person. The Cato Institute, a think-tank in Washington, DC, reckons that two-thirds of the windfalls of the 1990s, when actual revenues exceeded forecast ones, went on new spending.

The states argue that some of this was due to costs beyond their control. Spending on Medicaid, the health-care safety net for the poor (and the third-largest item on many state budgets), jumped by 14% this year, thanks to costly new technology and the increasing demands of an ageing population. They also blame the federal government for devolving spending responsibilities to them without enough concomitant revenue.

This argument is bogus. During the 1990s, federal grants to the states rose by around half in real terms, to $241 billion in 2000. Despite its recent rise, medical inflation fell during most of the 1990s. Most important, welfare rolls have halved because of the astonishing success of the 1996 welfare reform.



The combination of lower-than-expected taxes and higher-than-justified spending is causing a mad scramble to make budgets balance. Seventeen states revised their plans in the middle of this fiscal year, cutting spending, cancelling or delaying capital projects, issuing more debt and, in four states, raising taxes (by more than 5% in Arizona and New Hampshire).

Almost all had to draw on their reserves. These are best measured as the year-end balances (see chart 3). They fell by an aggregate $10 billion in 2001 to $34 billion, the first drop since 1992. True, that still covered 8.2% of spending. But in fiscal 2000 the cushion had been 11.5%.

Last year, the Centre on Budget and Policy Priorities found that only three states had enough reserves to maintain spending through a three-year recession without tax rises: Iowa, Maine and North Dakota. It is not certain that any now do. And a dozen states are starting to make Wall Street nervous. The rating agencies like the states to keep a balance of at least 5% of spending. In 2000, 40 states were above that point. Now 36 are.

Bad as all this sounds, it has been worse. John Engler, the governor of Michigan, says that those who think it is a crisis have no sense of proportion. “Some of us were looking at billion-dollar budget holes [in the early 1990s]. It isn't that bad.” He is right. The rainy-day reserves are higher than they were between 1980 and 1996. And states cut taxes by a net $1.8 billion in fiscal 2001, the seventh year of tax cuts.

All the same, the states' fiscal pinch exposes the structure of their tax systems for the ugly mess it is. Most states are too dependent on revenues from the consumption of goods and from manufacturing firms. The tax base is shrinking as the economy switches to services.

For many years, increasing revenues enabled them to paper over this deficiency. In some cases, the boom years encouraged them to make matters worse by removing stable elements of consumption from their tax bases (for example, Florida announced a tax holiday for clothing sales this year; Virginia has cut its tax on groceries). This has left them more dependent on big-ticket items that fall disproportionately during a slowdown.

Moreover, the budget squeeze may have big political consequences. In 1990, before the last bout of fiscal trouble, the Democrats controlled 29 governorships. By 1995, Republicans controlled 30. Of course, the states' fiscal problems were only one reason for this turnabout. Still, the troubles could swing the pendulum some way back in 2002, when the Republicans will be defending 13 governorships, compared with the Democrats' seven.

The budget squeeze is already endangering the states' deserved reputation for bipartisanship. Almost everywhere parties, governors and state legislatures are bickering about numbers. Seven missed their budget deadlines. Three have not passed a budget yet.

In Tennessee, facing a deficit of $550m-880m, legislators abandoned the idea of introducing a state income tax after protesters threw stones through the windows of the legislature. Eventually, they balanced the budget by dipping into the state's tobacco-settlement cash, which was meant to be off limits. The governor vetoed the budget. The assembly overrode the veto. The governor has called for a special session to change the dysfunctional tax system—his third attempt in as many years.

Much of this had to do with partisan guerrilla warfare. But in California, where Democrats control the governorship and both legislative houses, the politics was no more seemly. The governor agreed to an increase in the sales tax (triggered automatically by the decline in the state's balance sheet) and to the use of $1.3 billion in transport money to balance the budget. But opponents introduced “poison-pill” amendments which could undo this deal and cause more trouble next year.

For George Bush and Congress, there are any number of dangerous portents in all this: that state revenues tend to fall earlier than federal ones (and the first signs of a decline in the states appeared a year ago); that years of tax cuts and higher spending can lead to a sudden collapse in even the plumpest financial cushion; and that, when this happens, fiscal troubles that have a modest economic impact have big, unpredictable political consequences. Not the happiest background for the coming federal budget battle.

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High-speed rail

Trop peu, trop tard, trop Amtrak

Aug 9th 2001 | CHICAGO
From The Economist print edition

Fast trains may be coming to the mid-west—and stopping too often

THE roads are clogged. The airports are worse. Might fast trains provide relief for America's frustrated travellers? A coalition of nine mid-western states has plans for a rail system that would whisk travellers between the region's big cities at high speeds and connect them to points beyond with a network of slower trains and buses. Strangely enough, Congress, which would have to pay much of the cost, is warming to the idea.

The Midwest Regional Rail Initiative (MWRRI) is a joint venture between nine state transport agencies, the Amtrak rail system and the Federal Railroad Administration. The coalition has unveiled detailed plans and cost estimates for a 3,000-mile rail system with Chicago as its hub that would connect cities such as Detroit, Milwaukee, St Louis and Minneapolis at speeds of up to 110 miles per hour (some 50-75mph slower than French or Japanese trains, but enough to wow the mid-west).

Randy Wade at Wisconsin's Department of Transportation claims that the region is ideally suited for high-speed rail. Over distances of several hundred miles, such as the 280-mile trip from Chicago to Detroit, rail is potentially faster, more comfortable and more productive than car travel. It should be cheaper than flying and delivers passengers into the city centre, rather than to distant airports. And cities in the mid-west are already connected by freight rail lines that can be upgraded to accommodate faster trains. MWRRI thinks that a well-run system could attract nearly 10m riders a year by 2010.

Such transport visions are two a penny and often worth as much (ask any Eurotunnel shareholder). The General Accounting Office recently estimated the cost of a national high-speed system to be $50 billion-70 billion. But both the Senate and the House are considering bills that would enable Amtrak, America's quasi-public passenger rail agency, to issue up to $12 billion in bonds to pay for capital improvements in 11 designated high-speed rail corridors. The bonds would not pay interest; bondholders would receive federal income-tax credits instead.

Such stealth subsidies are unlikely to irritate voters, impatient with traffic jams and cancelled flights. “You can't imagine congestion getting better anywhere—ever,” says Mr Wade. Tom Daschle and Trent Lott, the Democratic and Republican leaders, are among the bill's 51 co-sponsors in the Senate. The White House has not taken a position yet; but, while he was governor of Texas, George Bush cut the ribbon when Amtrak began running the Texas Eagle from San Antonio to Chicago.

The bill making its way through Congress would provide a down-payment on the MWRRI plan, which can be built step by step. The full system will need lots more money, to pay among other things for the trains and improved infrastructure. Even supporters concede that high-speed rail would do well to cover its operating costs, never mind the capital investment. Politicians will have to be sold on the social benefits of getting Americans off the highways and runways.

Which they might be, except for the most potent enemy of passenger rail in America: Amtrak itself. Critics of federal spending for high-speed rail do not oppose the idea in principle; they just think that giving Amtrak control over something like $12 billion in capital spending is insane.

America's passenger rail system, which was deregulated in 1997, is supposed to cover its operating costs by December 2002. It won't. Amtrak has done little to trim inefficient routes or reduce bloated labour costs. It loses an average of $20 on every ticket it sells and several hundred dollars a ticket on some routes, says Senator John McCain. In June, Amtrak mortgaged a portion of New York's Penn Station in exchange for a $300m loan to cover costs through to the end of its fiscal year.

The politicians themselves are partly to blame. One reason why Amtrak is so lousy is its penchant for stopping its trains at every city on its route that has an influential politician just in case he (or one of his voters) happens to be standing on the platform. “Most senators treat Amtrak as a low-grade entitlement programme,” says one congressional staff member. There will be nothing high-speed about an express from Chicago to St Louis that stops nine times in between. This is one industry where people in America badly need to talk to the French.

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Mr Bush's report card

Not bad, so far

Aug 9th 2001
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Foggy Bottom Academy

George junior's first term as president of the student body has been, on balance, a success. In the final week before the summer holiday, he surprised us all by passing his preliminary examinations in health-care studies and energy. Together with a solid achievement in his economics classes, this gave him three credits for the term—a good start.

Economics	George has been concentrating on fiscal studies this term. He has shown a commendable interest in supply-side theory, though his decision to return the overpayment of school fees to parents is worrying the trustees of the school pension plan.	B
Mathematics	Fuzzy.	C
Foreign languages	George has made good progress in Russian and has overcome his initial difficulties with Chinese characters.	B+
Civics	George is working on a special project about the role of churches, mosques and other religious organisations in the provision of social services. This is a praise-worthy aim, but George has so far shown little understanding of the separation of church and state. Must do better.	D
Biology and ethics	George has been studying diligently, but his paper on stem cells was handed in late, so has not been marked.	No grade
Environmental studies	Our Japanese teacher, Mr Kyoto, reports that George has been inattentive in class and keeps interrupting to dispute his lessons.	C
Relations with other schools	The joint outings with our Russian colleagues at the Ivan the Terrible (formerly Lenin) Middle School were adjudged a success. But George needs to learn that it is not always in his interest to refuse to work with other schools just because he disagrees with them.	B

General deportment George came to us with a reputation for civility and being able to work with people. He has only partially justified that reputation. His low-key style has come as a relief after the scandals that affected the school last term. He is extremely popular among his friends. But his promise to be "a different kind of class president" has not been fulfilled. Those who disliked him at first have not been won over. He has also had disciplinary problems in Senate house. But he has plenty of time to improve. We wish him a restful summer holiday and a successful winter term.

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Bill Clinton's real home

It's Arkansas, stupid

Aug 9th 2001 | LITTLE ROCK, ARKANSAS
From The Economist print edition

Blow his memoirs, wait for his library and the chance he might run again

AP

Sticking around?

A LOYAL band of Democrats will gather in the little town of Arkadelphia this Saturday, August 11th, for their annual Clinton Day Dinner. The former president, who this week signed a deal worth $10m to write his memoirs, will not be there—he calls Harlem his home these days—but Arkansans have not forgotten him.

Last week a sizeable crowd in Little Rock listened to Bill Clinton talk about his planned presidential library, which will cost anywhere up to $200m. A local telephone company has already given $250,000 towards its race-reconciliation centre. After his speech, some of the audience chased Mr Clinton down, you guessed it, President Clinton Avenue to snap his picture, get his autograph or beg him to run for the Senate next year.

That looks premature: the probable Democratic nominee for next year's race, Mark Pryor, is an old friend of Mr Clinton. But Little Rock still whispers about the possibility of a deal with another Democrat, Senator Blanche Lincoln, whose term ends in 2004. The prospect of a battle with Mike Huckabee, the Republican governor and Enemy of Bill, who has eyes on that Senate seat, could tempt the great author back into the fray. Ms Lincoln could be found a local job—such as, well, Mr Huckabee's.

Mr Clinton's long-suffering supporters seem to have blamed the move to New York on his Yankee wife. The glass-and-steel Clinton library, on which work starts soon, will overlook the Arkansas river in the 28-acre William Jefferson Clinton Presidential Park. It will hold the country's largest collection of presidential papers and artefacts, now temporarily housed in a former car dealer's showroom.

The library, like its namesake, is not without controversy. It still faces a couple of lawsuits, one of which asks awkward questions about the money that Little Rock raised to buy the land the library needs. The city issued $16.5m in park revenue bonds, backed by the fees that visitors pay at Little Rock's zoo and its golf courses. Better, some argue, if the money had gone to the zoo itself and the city's parks, which badly need it. In many parks, public lavatories have been shut for lack of money.

Roland Remmel, an elderly and popular Arkansas politico known for giving away walking-sticks called Rollie Sticks, has launched a one-man campaign to raise money for the reopening of the parks' lavatories. But even his disgruntlement did not stop him presenting Mr Clinton with a Rollie Stick last week on the street named after the former president.

Little Rock's leaders estimate that the Clinton library will put nearly $60m into the city's economy in its first five years. The River Market District, near the library site, is thriving as a new entertainment and shopping centre. Heifer Project International, a hunger-relief organisation, plans a multimillion-dollar project nearby.

This week Hot Springs, where Mr Clinton spent most of his early years, releases its first batch of Bill Clinton baseball cards. Hot Springs says it has had calls about the cards from all over the world. And Mr Clinton, in return, hasn't forgotten Hot Springs. He plans to build a Camp David-like retreat on a lake there, to which he can invite notables from around the globe—and perhaps think about that Senate run.

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Reproductive fantasy

Spin doctors

Aug 9th 2001
From The Economist print edition

Cloning still looks far too dangerous to attempt

IF CLONING a human being were as easy as reproducing a media storm, then Severino Antinori, an Italian doctor, and Panos Zavos, an American researcher, would be masters of their craft. In March, the pair caused a furore in Rome when they announced that they would start cloning a human being by the end of the year. This week, the controversial couple, together with Brigitte Boisselier, the head of Clonaid, the cloning arm of the Raelians (a slightly weird sect), repeated the trick for the cameras at America's National Academy of Sciences.

The academy is supposed to present a report on cloning to Congress in the next month. Dr Antinori says his goal is to tackle male infertility. Genetic material from men who are unable to have children (even with the latest fertilisation techniques) will be put into eggs, and the embryos allowed to develop into babies. Such nuclear transfer produced Dolly the sheep, the world's first cloned mammal, four years ago. As for Clonaid, its more disturbing ambitions include a plan to clone a dead child.

Just how far the cloners' experiments have progressed is a matter of much speculation. With so many infertile people desperate to have children, money is not the problem. Although one of Clonaid's prospective backers is having second thoughts, both Dr Antinori and Dr Boisselier claim to have enough cash (at least $1m) to clone a person. There are plenty of volunteers willing to donate cells or provide a cosy womb for the cloned creation.

Nor is location much of an obstacle. Shaun Pattinson, a legal expert at Sheffield University, points out that, although governments talk tough on cloning, few have actually banned it. Britain's Parliament, for example, passed a law this year allowing so-called “therapeutic” cloning for the purpose of creating stem cells for research, but it has yet to enact the government's promised ban on reproductive cloning. America must wait to see if the Senate will uphold the recent vote in the House to prohibit all forms of human cloning.

The real hurdle for the cloners is their expertise (or complete lack of it). Even experienced animal cloners need hundreds of egg cells to produce only a handful of live cows or sheep. The difficulty lies, not so much in actually moving nuclei about or manipulating embryos, but in understanding what goes wrong along the way. Problems in gene development lead to high rates of death and deformity in cloned animals, for reasons that scientists scarcely understand and have little means of preventing. Until these problems can be worked out in animals, the road to human cloning could be filled with needless casualties. That prospect should be more than a little troubling for the two doctors.

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Lexington

A Republican sex change

Aug 9th 2001
From The Economist print edition

George Bush's new soppy values strategy looks risky

THE Democrats are supposed to be the “mommy party” and the Republicans the “daddy party”. Voters expect the Republicans to deal with manly problems like the economy and defence while the Democrats worry their pretty little heads about education and the environment. But for how much longer? George Bush is doing more on his four-week holiday at his ranch in Crawford, Texas, than taking invigorating walks in the 100-degree heat. He is masterminding a Republican sex change.

Just before Mr Bush skipped steamy Washington for somewhere even hotter, the White House dropped a series of heavy hints about things to come. Henceforth macho issues like taxes and energy will take a back seat to “values” (whatever they are), communities (ditto) and families. Mr Bush will unveil plans to provide prescription medicines for seniors and a welcome mat for immigrants. He will talk endlessly about his plans for education and faith-based care. His cringingly named “home to the heartland” holiday has already included the president helping put up a new house for a needy single mother.

The reason for this embrace of mommy issues is not hard to find. Mr Bush's job-approval rating is a solid if unspectacular 57%. But he does poorly with women and moderates. He also suffers from a widespread feeling that he is out of touch with ordinary people—that he cares more about corporate bosses than working stiffs. The new values agenda is intended to put a human face on the administration. It is also meant to make good Mr Bush's repeated promise during the election that he is a different sort of conservative—a compassionate conservative.

The further Oprah Winfreyisation of American politics is not an edifying prospect. But emphasising values has a long and distinguished tradition in American life. James Madison argued that republican governments require a higher degree of virtue among their citizens than do other forms of government. Thomas Jefferson argued that one of the benefits of self-government is that it helps to form character. Opinion polls repeatedly show that Americans regard moral decline as one of the most urgent problems facing the country—and that combating it requires a mixture of voluntary effort and government initiative.

Whether this new phase in Mr Bush's presidency owes more to Oprah or Madison will become less important than whether values can be given political substance. William Galston, who, poor man, was Bill Clinton's values man for a while, points out that it is hard to sustain the president's involvement when more urgent issues command his attention. Cultural trends, he adds, are particularly difficult to change. Mr Bush also faces a couple of problems that are specific to his brand of conservatism.

First, embracing mommy issues could lead inexorably to embracing mommy solutions. Compassionate conservatism was supposed to tackle liberal issues with conservative solutions. Rather than ceding things like poverty or education to Democrats, as the elder Bush had, the president would point out that the best way to reduce poverty is to discourage illegitimacy and the best way to improve education is to challenge the public-school monopoly with vouchers. Yet on education, his signature issue, Bush junior has mutated into Bush senior, surrendering his tiny voucher provision without a fight, watering down tests and failing to speak out against bilingual education, despite the evidence from California that getting rid of it improves the performance of non-English-speaking children.

Mr Bush's second problem is that the most innovative bit of his moral agenda—his faith-based initiative—is a Pandora's box. The separation of church from state matters hugely to many voters, and not just because they want a secular government. Chet Edwards, the Democratic congressman whose district includes Mr Bush's ranch, worries that federal regulations will “make our houses of worship an arm of the government”. America's private churches, he points out, are full, whereas churches in Europe, where there is greater state involvement, are empty.

The cynical view is that none of this matters. Mr Bush doesn't actually have to fix inner-city schools or cure homelessness. He just has to persuade swing voters that he cares about people other than company bosses. But, even judged in these terms, many of the ideas that the administration has come up with look insubstantial or worse. There is talk about making it easier for grandchildren to e-mail their grandparents, persuading news organisations to report more good news and promoting films that “do not further racial stereotypes”. Republican enthusiasm for these ideas will hardly be increased by the fact that some White House officials are going around saying that they want to deliver Clintonism without Clinton.

The preacher mustn't mutter

Worse, the whole thing may end up drawing attention to Mr Bush's biggest weakness: his poor performance as a communicator. There are few greater tests of a president's rhetorical skill than his ability to address moral issues. Remember John Kennedy's injunction that Americans stop asking what their country could do for them? But so far Mr Bush has been at his weakest in using the bully pulpit. He has a way of looking small and out of place when he speaks in public—like a schoolboy who has been put on the podium by mistake. In addressing moral issues, Mr Bush will need to walk a particularly fine line between sounding judgmental and coming across as merely vacuous. The worry is that he will fall flat on his face.

Mr Bush demonstrated at the Republican convention that he is a master of the politics of mood music. He may also be able to persuade people that his education reforms, for all their flaws, provide the substance that his new agenda needs. But dealing with mommy issues is likely to prove much harder than dealing with the good old Republican staples that dominated Mr Bush's first six months. Perhaps a four-week holiday is too short.

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Central America

Small, vulnerable—and disunited

Aug 9th 2001 | MEXICO CITY AND SAN SALVADOR
From The Economist print edition

Central America has been trying to get itself together for over 160 years. Could a new development plan from Mexico give it the push it needs?

A graveyard for sustainable development

IN 1839 John Lloyd Stephens, a lawyer and adventurer, was dispatched by the United States to find the government of the Central American Republic and to establish diplomatic ties. His ten-month trek through the jungles made him famous as both a travel writer and an archaeologist, but as a diplomat he was less successful. “After diligent search,” he reported, “no government found.”

There was none. The short-lived Central American federation had already begun to split into the separate republics of Guatemala, Honduras, El Salvador, Nicaragua and Costa Rica; Panama appeared later, a splinter of Colombia. Small, mostly poor, and vulnerable to economic change and natural disasters, they would have much to gain from refederation, or at least co-operation. But their attempts at integration have been fitful.

The original five linked up in the Central American Common Market (CACM) in 1960, but its progress was halted first by a brief war between El Salvador and Honduras, and then by guerrilla conflicts in several countries. In the past decade the wars have ended, the common market has been revived, exports have risen and economic growth has returned. Regional institutions have proliferated and several grand integration schemes have been proposed. The latest proposal is the Puebla-to-Panama Plan, a

development plan peddled by Mexico's new president, Vicente Fox, for the south of his country and for Central America. This week the region's finance ministers met at the Inter-American Development Bank (IDB) in Washington to discuss how to raise money for it. But despite all this, the dream of uniting Central America seems as distant as ever.

Trying to merge unequals

Combined, the population of the Central American six is similar to that of California, but their GDP is smaller than that of Mississippi. They face many common problems, which would be easier tackled jointly, according to “Central America 2020”, a recent study of the region's prospects commissioned by the European Union and the United States Agency for International Development. It reports that only 10m Central Americans are real consumers; total demand is worth less than that in Mexico city. Coffee is a main export, but all of Central America sells less than Vietnam. Much of the isthmus has been scarred by environmental damage, which exacerbates its vulnerability to natural disasters (the floods of Hurricane Mitch in 1998 hit deforested areas especially hard). Businesses tend to be small and weak, and to lack credit. Health and education systems, and political institutions, are also generally weak (though Costa Rica's are an exception). As well as corruption, several countries suffer from a post-war surge in violent crime. Poverty and inequality are deep-rooted. Only one Guatemalan in five goes to secondary school, but Guatemala city has more helicopters per person than any other city in the world, for example.

EPA

A graveyard for sustainable development

In the 1960s the goal of integration was to create a protectionist trade block. Now, says Oscar Santamaria, the head of the Central American Integration System, “integration is not seen as an end, but as a means to development”. As well as a customs union, most officials say that in the long term they want European-style integration, with closer political links and a single currency, probably the dollar.

But even the customs union is not yet a reality. Since 1996, the trend has been away from a common external tariff: average external tariffs among the five CACM members vary from 4% to 12%, and some countries still levy tariffs on their neighbours' exports. Miguel Lacayo, El Salvador's economy minister, estimates that tariffs, other charges and customs delays at borders cost 2-3% of regional GDP a year. Neither is business always enthusiastic for change. Flour millers that enjoy national monopolies have resisted free trade, for example. Though the financial industry is slowly consolidating, the five countries still have 125 banks between them.

Behind that spotty progress lie big obstacles to integration. The first is the astounding variation in development (see map at the top: click to enlarge). Costa Rica's GDP per person is six times that of Nicaragua, a gap almost as large as that between the United States and Mexico. History has a lot to do with it. Costa Rica, whose economic backbone was family-run coffee farms set up by European migrants, has been a democracy for half a century. El Salvador, Guatemala and Nicaragua were plantation economies, and have suffered civil wars of varying lengths. Honduras remained stable, albeit under mainly military rule, until 1982, but has been condemned to poverty by difficult geography and poor soil. Panama has stood apart, sustained by its canal, banks and free-trade zone.

So Central America rarely functions as one. Richer Costa Rica and Panama, scared of being dragged down by their poorer neighbours, have always been sniffier about integration (Panama is not even a member of CACM). The other four are working alone on, for example, standardising registration procedures for foods and medicines. The fastest pace of integration has been set by El Salvador and

Guatemala, which are planning a bilateral customs union with common collection of customs revenue. El Salvador last year joined Panama in adopting the American dollar as its currency; Guatemala now uses the greenback alongside its quetzal. Last year, with Honduras, the two fast-movers signed a free-trade treaty with Mexico. Costa Rica has struck its own free-trade deals with Canada and Mexico. Panama has been left out of regional trade deals with Chile and the Dominican Republic. Belize, a tiny former British colony, is keen to join the fun; its officials try to learn Spanish, but they are only observers in most regional discussions.

Another year, another plan

All in all, there are some 30 regional bodies, from a parliament (in Guatemala) to a court of justice (in Nicaragua) to a disaster prevention centre (in Panama). But they have little or no power. Guatemala and Costa Rica, for instance, do not recognise the court. Important institutions are missing, too: there is no mechanism for settling trade disputes, nor any regional body to negotiate trade deals with third countries.

Enthusiasm for integration ebbs and flows according to the whims of governments. At present El Salvador is keen, but Costa Rica, Honduras and Nicaragua are preoccupied with forthcoming elections. Anachronistic border disputes do not help: Honduras and Nicaragua slapped punitive tariffs on each other's goods last year as they squabbled over a patch of sea.

Enter Mexico's Mr Fox. One of the biggest difficulties he faces is to narrow the gap between northern and southern Mexico, which rivals those between Central American countries. Doing that while also helping the region looks like a good way to rustle up more money. Mr Fox's ambitious Puebla-to-Panama Plan would link nine states in southern Mexico to the isthmus with new roads and electrical and telecoms links. The plan also calls for integrated disaster prevention; better health, education and housing; investment promotion; stronger national and regional institutions; and environmental protection.

Nice idea, albeit not quite original. The Central American part of Puebla-to-Panama draws on a proposal by the now-defunct Harvard Institute for International Development and INCAE, a Costa Rican business school, formally adopted by the region's presidents in 1999 (not that they did much with it). This advocated “clusters” of development in four industries: textiles, high-value agribusiness, electronics and tourism. Puebla-to-Panama also gives a nod to the “Central America 2020” report, which calls for less reliance on export-led growth and more support for small businesses, and a more participatory approach to development.

Opponents of the new scheme worry that the talk about protecting the environment and helping the poor will remain just talk, and that the plan will create uncontrolled industrial growth of the kind that has turned Mexico's border with the United States into an environmental and social disaster. “Central America doesn't have a clear agenda of its own,” says Roberto Gochez of Funde, a left-wing think-tank in San Salvador. “The institutions are weak and the rules, for example in negotiating free-trade agreements, have often been ignored.”

The scheme's backers have other questions to answer, such as how to pay for and execute it. The Puebla-to-Panama financing committee is supposed to present a first report by September. But Enrique Iglesias, the IDB's president, has admitted that it will be hard to drum up enthusiasm until the projects are better defined.

That may take a while, both because of the plan's complexity but also because of the way it is run. A central staff of just 12 people, based in Mexico city, will parcel out tasks to committees involving everyone with an interest: state and local governments, social groups and business organisations. That way, hopes Hector Fereira, the project's deputy director, it may not be rejected as a diktat from Mexico city.

Perhaps, but it also means things will happen more slowly, and local problems are likely to hold things up. One obstacle is the Zapatist rebellion in Mexico's southern state of Chiapas. Mr Fox's efforts to end the rebellion have failed, the state remains tense and full of soldiers, and the Zapatists are sceptical of capitalist development.

That Puebla-to-Panama is the first development plan for Central America with a single outside backer (Mexico) may help it forward. But its success will still depend on the politicians who must put it into practice, and in particular on how keen, organised and honest they are—all of which varies greatly from

one country to another. As a modern-day Stephens might observe: “After diligent search, many governments found, some better than others.”

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Bolivia

One-year wonder?

Aug 9th 2001 | LA PAZ
From The Economist print edition

The new president is in a hurry

JORGE QUIROGA is not a typical Latin American politician. Boyish, intense, workaholic, American-educated and fluent in English, he comes across as what he once was: a sales manager for IBM. On August 7th he was sworn in as Bolivia's president. But he has only a year to test whether his brand of conservative technocracy can lift one of South America's poorest countries out of its discontents.

Mr Quiroga replaces Hugo Banzer, who has stepped down after only four years of his five-year term because he has cancer. The change is a generational one. Mr Banzer had been a central figure in Bolivia's politics since the 1970s, when he ruled as a military dictator. Mr Quiroga, aged 41, is Bolivia's first president to be born after the country's nationalist revolution of 1952.

Mr Quiroga, who was the vice-president, leads the modernising wing of Mr Banzer's conservative National Democratic Action (ADN) party. He has little in common with the retired generals who made up Mr Banzer's inner circle. But he is likely to stick with many of his former boss's policies. He has praised Mr Banzer for having turned Bolivia from a coca economy to a gas economy.

Unfortunately, Mr Banzer's success in eradicating most of Bolivia's coca crop, and thus much of its drug industry, has come at a cost in jobs. Despite the benefits of natural gas, the economy has been languishing, a victim of external squalls. Unemployment and crime are rising, and the government is unpopular, partly because of corruption scandals. Bolivia risks a “profound crisis”, says Carlos Calvo, the head of the private business association.

Mr Quiroga has good relations with the United States, and with the international financial institutions. That could be helpful. Although creditors approved an “enhanced” debt-relief scheme for Bolivia in June, more is needed to get the economy moving. With government revenues falling, Mr Quiroga has said he will cut spending on bureaucracy. He has also promised to attack political patronage and corruption, partly by creating a civil service.

The old guard in the ADN, and its coalition partners, have given Mr Quiroga a free hand in forming his cabinet. But a general election is only ten months away. Ten months, however, is a long time in Bolivian politics: almost half of its 79 previous governments lasted less than a year.

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Mexican politics

Love in the PRI

Aug 9th 2001 | MEXICO CITY
From The Economist print edition

Mexico's former ruling party reverses its losing streak

FOR the Institutional Revolutionary Party (PRI), a narrow victory in the election for governor of the state of Tabasco on August 5th was a breath of life. The party that ruled Mexico for 71 years had been looking as sorry as a stray dog: not only did it lose the presidency last year, but it had not won a state poll in almost two years.

Victory is particularly sweet because the election was a re-run of one held in October and annulled because of alleged vote-rigging by the PRI and Tabasco's governor, Roberto Madrazo. This time the PRI won by a fairly convincing margin, of almost five percentage points. Its candidate, Manuel Andrade, aged 35, had two decades of local political activism behind him.

Another winner, though, is Mr Madrazo, who had slunk off to the United States after the October fiasco. Broadly speaking, the PRI is split between modernisers, who ran the previous government and dominate the current party leadership, and traditionalists like Mr Madrazo, who tend to favour protectionism and a strong state. Since losing the presidential nomination in 1999, Mr Madrazo has had his eye on the party chairmanship. The Tabasco election was widely seen as a test of his credibility for that job.

A new leader is badly needed. So, too, is a strategy. Out of power, the PRI does not know where to put itself in the political spectrum. The right is occupied by President Vicente Fox's conservative National Action Party (PAN). The fuzzy, social-democratic centre arguably belongs to Mr Fox himself, never a traditional PAN man. For the past dozen years, the left has been the province of the Party of the Democratic Revolution (PRD), many of whose leaders were PRI dissidents.

The PRI's confusion makes for strange bedfellows. Last month it joined the PRD in sponsoring a meeting in Mexico of the Socialist International. Does this mean it is heading leftwards? No, says Fidel Herrera, a PRI senator: “We want to take the broad centre. We can accommodate everything from socialism to Christian democracy.”

The PRI's efforts to woo young voters, who shunned it in the presidential election, are equally haphazard. They range from a proposal for an all-inclusive “youth law” on how the state should deal with young people's needs, to a dating service on the party's website, exhorting people to “find love in the PRI”.

The leadership also wants at least a third of the delegates to its party congress in November to be under 30. That is when Mr Madrazo, who at 49 is young by PRI standards, will make his leadership bid. If he were to win, many modernisers would leave the party. So though Tabasco may have made the PRI happy for now, it could mean tears later on.

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Colombia

Peace recedes

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From The Economist print edition

The collapse of talks with the ELN guerrillas is a victory for the paramilitaries

SEVERAL times during the past three years, the government of President Andres Pastrana has seemed close to clinching a peace deal with the National Liberation Army (ELN), the smaller of Colombia's two main left-wing guerrilla groups. But on August 7th an exasperated Mr Pastrana said that he was "suspending" contact with the ELN. There was an air of finality about that announcement, made before military chiefs at an independence-day parade. The ELN, too, said that hopes of peace before Mr Pastrana steps down in a year's time were "almost dead".

The main obstacle is the ELN's demand for a haven in the south of Bolivar department, in northern Colombia, in which to hold formal talks. This is opposed by the local residents, egged on by the right-wing paramilitary vigilantes of the United Self-Defence Forces of Colombia (AUC). The ELN had broken off talks about talks in April, after the government failed to set up the haven. Mr Pastrana's announcement followed further talks in Venezuela. Camilo Gomez, the government's peace commissioner, said that at the behest of hardliners the ELN had at the last minute rejected a deal for a smaller enclave.

What now? Officially, the door remains open, said Mr Gomez. But the army has never been keen on talks with the ELN. Some commanders believe that the group can be defeated. To refute that view, the ELN is now likely to resort to mass kidnappings or sabotage attacks.

The only victor from the breakdown of the talks is the AUC. It has done its bloody utmost to drive the ELN out of southern Bolivar. By offering the enclave, then failing to set it up, Mr Pastrana has shown his government's impotence. The AUC rammed home the point this week: in San Pablo, the area's main river port, its sympathisers prevented a group of 68 European activists from landing. The activists had planned to distribute aid to civilian refugees.

Mr Pastrana had been basking in an improbable surge in popularity, the result of the Colombian national team's victory in the South American football championship. But Colombians are increasingly fed up with the failure of his peace efforts. Talks with the FARC, the main guerrilla group, have moved slowly. The next government is likely to take a tougher line. Horacio Serpa, the Liberal candidate and, according to the polls, the likeliest winner of next year's presidential election, launched his campaign this week warning the guerrillas that, if they wanted war, he would be their "most committed adversary". A framework may have been laid for peace, but it is a flimsy one.

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China

Beidaihe beach blues

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From The Economist print edition

As China's leaders take their annual seaside break, storms are brewing over future policy and who is to get the top jobs

DURING his summer holiday at the beach resort of Beidaihe, President Jiang Zemin must be getting precious little time to relax. In their secluded and heavily guarded seaside villas, he and his colleagues need to make some big decisions. Over the next two years China will undergo sweeping leadership changes and, if Mr Jiang has his way, refashion its ideology to embrace the country's fast-growing class of capitalists. There are signs that his plans are not going smoothly.

Mr Jiang, like Deng Xiaoping and Mao Zedong before him, likes to keep up the annual tradition of retreating to Beidaihe on the Bohai Gulf to escape Beijing's blistering summer heat. While the masses swarm on crowded beaches in the centre of town, Mr Jiang and his colleagues enjoy a roped-off stretch of prime sea-front well away from prying eyes. On a hillside overlooking the beach is a tree-shrouded compound where they meet informally to make the decisions that will later be rubber-stamped at Communist Party gatherings back in Beijing.

This year's discussions at Beidaihe are particularly crucial. Mr Jiang wants to cling to power well beyond the party's 16th congress, due to be held late next year. He is prepared to give up his job as party general secretary, and the constitution requires him to step down as president of China at the annual session of parliament in early 2003. But even though he turns 75 next week, he wants to remain chairman of the Central Military Commission, in practice as powerful a job as any.

That is galling to some of Mr Jiang's colleagues. His deputy in the party, Li Peng, is only 72 and sees no reason why he should have to go if Mr Jiang is allowed to stay on. Zhu Rongji, the prime minister, is also 72. Unusually for a Chinese leader, he actually wants to retire, but he is worried that his economic reforms may come unstuck if the conservative Mr Li manages to stay in power without him. Having shaken off its gerontocrats by natural attrition in the 1990s, China is now in danger of lumbering itself with a whole new set.

Mr Jiang wants to ensure that next year's congress admits him to the pantheon alongside Deng and Mao as one of communism's great innovators. But it is proving a struggle to rally the party around his recent ideological bombshell, the idea of admitting the bosses of private enterprises as party members. Mr Jiang all but declared this as policy in a speech on July 1st marking the party's 80th birthday.

Twelve years ago, soon after he was appointed general secretary, Mr Jiang publicly scorned the idea of

recruiting capitalists, and hardliners are enraged by the volte face. Letters by conservative ideologues attacking him have been circulating on the Internet. They accuse Mr Jiang of breaking the party charter, and warn that admitting capitalists could weaken the party's discipline and cause it to break up.

Mr Jiang has tried to shore up his position by forcing party organs to declare their loyalty. Since late last month, expressions of support for Mr Jiang's speech from round the country have dominated the front page of the party's mouthpiece, the *People's Daily*. For days, the same Orwellian headline has greeted readers: “Thoroughly Study the Speech. Unify Thoughts and Actions”. There is no surer sign in China of political disunity than such a persistent media campaign.

Mr Jiang is trying to keep the party conservatives in check. Officials have been quietly warning the authors of the Internet letters, as well as journals under the control of hardliners, to desist from their attacks. They have also blocked some websites carrying the hardliners' views.

The man who will almost certainly take over from Mr Jiang as general secretary after next year's congress, Hu Jintao, has praised the July 1st speech as a “Marxist programmatic document”. Mr Hu is indeed sympathetic: scholars close to him have been studying Europe's social-democratic parties—presumably to see how their experiences might help China's Communist Party transform itself into a more broadly representative organisation.

But Mr Hu cannot be a happy man. He faces the possibility of years overshadowed by a semi-retired Mr Jiang. And he knows that he was Deng Xiaoping's choice as Mr Jiang's successor, not Mr Jiang's. At Beidaihe Mr Jiang will keep up his efforts to secure a top position for his own favourite, Zeng Qinghong. Last year Mr Jiang failed to persuade the normally compliant Central Committee to make Mr Zeng a voting member of the Politburo. Some leaders resent what they see as Mr Jiang's preference for former Shanghai-based officials such as Mr Zeng.

For all the mini-personality cult that Mr Jiang enjoys, he does not have the charisma and experience needed to impose his will on the party in the way Deng once did. Many officials privately question his judgment, on matters ranging from China's entry to the World Trade Organisation to the handling of relations with Taiwan and America. Winning the bid to hold the 2008 Olympics in Beijing must have been a big morale-booster, but not enough to ensure smooth sailing at Beidaihe.

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Japan

Shrine wars

Aug 9th 2001 | TOKYO
From The Economist print edition

Will Mr Koizumi go to Yasukuni?

Get article background

AP

Commemorating heroes, or criminals?

NO MATTER that television cameras recently caught his closest aide scouting out Yasukuni Shrine in preparation for a visit. No matter, too, that he promised before his appointment that he would definitely go. Junichiro Koizumi, Japan's prime minister, still insists that he is “thinking long, hard and without prejudice” about whether to go to the shrine that commemorates war criminals alongside the war dead, on August 15th, the anniversary of Japan's surrender at the end of the second world war.

If he decides to go, as he probably will, Mr Koizumi can at least count on some support from his own party, the Liberal Democrats (LDP). True, both Makiko Tanaka, the foreign minister, and Hiromu Nonaka, the former chief cabinet secretary, have voiced strong objections, and others, such as Koichi Kato, a former secretary-general, cautiously disapprove. But others still listen to the Japan Association of War-Bereaved Families, a powerful though ageing support group with close links to Yasukuni, which could, in its heyday not that long ago, rustle up a million or so votes for the LDP. In fact, it is partly because Mr Koizumi turned to it for support during the party's leadership battle in April that he pledged to go officially to Yasukuni when he won, says Minoru Morita, a political commentator.

Mrs Tanaka has toned down her protests after a high-volume dispute with Mr Koizumi last week. It started when Mrs Tanaka refused to replace Japan's ambassador in Washington, in a personnel shuffle to clean up the scandal-ridden foreign ministry. She gave way, but then clashed again with Mr Koizumi over the name of the new ambassador. Mrs Tanaka, whose popularity rivals the prime minister's, was almost sacked, backing at the last minute.

But New Komeito, Mr Koizumi's biggest coalition partner, bitterly opposes the visit to the shrine. The party is backed by the Soka Gakkai, a Buddhist organisation that was persecuted during the war by leaders of state Shinto, for which Yasukuni served as the principal shrine. But New Komeito's disfavour has, in some ways, made it harder for Mr Koizumi to back down, since many LDP politicians resent the alliance. Opposition parties, led by the Democratic Party of Japan, are also against the prime minister's Yasukuni visit, but naturally carry less weight with Mr Koizumi.

Both Korea and China are furious that the prime minister should even consider visiting the shrine. Last month Tang Jiaxuan, China's foreign minister, sent a message to Mr Koizumi telling him not to go. It sparked anger from the Japanese right over what they called foreign interference. Korean and Chinese anger is the more heated because it follows a row over Japan's history textbooks, which the education ministry vets.

One reason why Mr Koizumi is being stubborn in the face of so much controversy is that the voters, the group best able to influence him, are split. Many do not understand why Korea and China are upset, or what an official visit to Yasukuni actually means. Such ignorance stems from decades of poor education in modern history, says Mr Morita.

So Mr Koizumi may feel he has little to lose, and much to gain, by going ahead with his Yasukuni plans. Even though his approval ratings are high, he fears losing the respect of the voters if he abandons his

pledges. His other election promises, to push ahead with painful reforms to help revive the economy, and, even more popularly, to reform his own party, will meet strong opposition, especially within the LDP. Mr Koizumi, who lacks strong support within his party, knows he must rely on his huge popularity among the voters and his carefully fostered image as a man who sticks to his word to get the job done.

But, say critics, Mr Koizumi has so far failed to grasp the long-term risks of going to Yasukuni. Nationalists are becoming more vocal and emotional, which, in turn, is fostering new distrust of the prime minister. He also risks endangering Japan's relations with its neighbours just as it is about to host football's World Cup with Korea and celebrate the 30th anniversary of the resumption of diplomatic relations with China next year. It may not be long before Japan ends up isolated in Asia.

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The Philippines

South Sea trouble

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A ceasefire in Mindanao is unlikely to bring permanent peace

A PLEBISCITE on August 14th is supposed to begin a new era of peace and development in the southern Philippine region of Mindanao, after more than three decades of Muslim separatist insurgency. The plebiscite, which offers autonomy to parts of the large island of Mindanao and some neighbouring islands, follows from a 1996 peace agreement between the government and the rebel Moro National Liberation Front (MNLF). In exchange for the promise of a vote on autonomy, the MNLF abandoned its campaign for full independence for the traditionally Muslim areas of the predominantly Christian country. But, unfortunately, things are not proving quite so simple.

In 1996 the government put the MNLF's leader, Nur Misuari, in charge of four mainly Muslim provinces that already had limited autonomy, and promised funds for economic development. Mr Misuari's hope was that by bringing prosperity to the area under his administration, he would encourage neighbouring provinces to vote in the forthcoming plebiscite to become part of a larger region, with more of its own powers.

But the 1997 Asian financial whirlwind dried up the supply of money for development, and Mr Misuari spent what little money there was on employing his followers instead of improving the lives of his constituents. Most voters are now expected to reject the offer to become part of an expanded autonomous region, so Mr Misuari has demanded—in vain—the postponement of the plebiscite.

Meanwhile, the MNLF has removed Mr Misuari as its leader, and on August 7th it formed an alliance with another Muslim separatist group, the Moro Islamic Liberation Front (MILF). The MILF opposed the 1996 agreement and the plebiscite. But peace talks between it and the government have at least been revived, and on August 7th the MILF agreed to a ceasefire.

Months or years of negotiation now lie ahead if the MILF's demand for full independence is to be reconciled with the government's insistence that the Philippines must not be dismembered. Even so, the government hopes that, simply by stopping the fighting and keeping the rebels talking, it can give Mindanao a chance to begin exploiting its potential in agriculture, mining and trade with neighbouring Malaysia, Indonesia and Brunei. Economic development, the government's theory goes, will diminish separatist sentiment among the Muslims.

The flaw in this strategy is that Mindanao is unlikely to develop unless the guerrillas give up their weapons. This is improbable, given the centuries-old custom in Muslim areas of bearing arms. A previous ceasefire between the government and the MILF quickly broke down. Many MNLF fighters still carry weapons. Then there are the “lost commands”—armed parties of former MILF or MNLF guerrillas loyal only to their own chiefs.

Some leaders of a third Muslim separatist group, the Abu Sayyaf, are former MNLF guerrillas who have turned to kidnapping for ransom. The Abu Sayyaf once again demonstrated its capacity for vicious mischief when it beheaded ten hostages taken on August 2nd. The government regards the Abu Sayyaf as bandits, and refuses to negotiate with it. But even if the government eventually manages to make peace with the MILF as well as the MNLF, a Mindanao infested by armed ex-rebels without a cause will hardly be conducive to development.

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Indonesia

Megawati names her team

Aug 9th 2001
From The Economist print edition

She puts stability and competence above reformist zeal or political ties

AP

It was worth the wait

THOUGH her accession as Indonesia's president had been planned for months, it still took Megawati Sukarnoputri more than two weeks to announce her cabinet. The delay was marked by lengthy negotiation between her advisers and rival parties, and raised fears that factionalism would cripple her new government. On August 9th, however, Miss Megawati reassured both her countrymen and the markets, naming a 32-strong team that is stocked with professionals.

Like her predecessor, Abdurrahman Wahid, Miss Megawati has made concessions to her rival parties. She included ministers from each of parliament's main factions, proclaiming that “national unity will be the first priority”. Miss Megawati had already agreed to this principle before Mr Wahid's removal, and with only 31% of parliament's seats she would have been punished had she reneged. Yet professional managers, rather than party hacks or retired generals, will nevertheless fill more than half of the posts in her cabinet, and only four of her ministers will come from Golkar, the tainted party of Suharto and the second-largest in parliament.

To take charge of the two most troublesome responsibilities—the economy and the armed forces—Miss Megawati chose ministers who are considered reasonably competent and honest, and who are not beholden to any political faction. The new co-ordinating minister for economics is Dorodjatun Kuntjorojakti, now ambassador to the United States. Mr Dorodjatun, whom Mr Wahid had considered for the same post, studied economics at Berkeley University. But unlike the “Berkeley mafia” that ran the economy for Suharto, Mr Dorodjatun was jailed for protesting against Suharto's economic policies. Miss Megawati hopes that his Washington contacts will help her deal more effectively with the IMF, which suspended aid under Mr Wahid.

A technocrat, Boediono, got the other main economic post, that of finance minister. Mr Boediono served in the 1998-99 government of B.J. Habibie, and optimists hope his knowledge of the bureaucracy will complement Mr Dorodjatun's diplomatic skills. Miss Megawati has made use of her party's best economic hands. She has put Laksamana Sukardi—a former banker whom foreign investors respect—in charge of state enterprises, and Kwik Kian Gie at the head of the economic-planning agency. The markets applauded.

Miss Megawati has also filled the most important military-related posts with people intended to reassure onlookers. Susilo Bambang Yudhoyono, a retired general, will co-ordinate security policy. He is a mild reformist, and served in the same post under Mr Wahid before the flailing president sacked him in a bid to maintain power. Miss Megawati has continued Mr Wahid's practice of naming civilian defence ministers, by appointing Matori Abdul Djalil, a leading member of Mr Wahid's faction who turned against him in the final weeks. In all, the new cabinet contains four retired generals.

Although it is a reassuring team, reformers want to know who will be Miss Megawati's attorney-general: surprisingly, no one was named among the first 32. Will she choose someone who will go after corrupt politicians and businessmen, or duck doing so in the interests of stability? The hardest decision has been left till last.

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Indonesia

The Black Bats strike back

Aug 9th 2001 | POSO AND TENTENA
From The Economist print edition

In the Indonesian island of Sulawesi, violence between local Christians and Muslim migrants from Java is rising

IT IS said that a group of killers in Sulawesi hold magic properties that make their enemies powerless when they pass. They are the Black Bats and they move at night through the heart of Indonesia's strange-shaped island of twisting peninsulas. Black is the colour of war, bat soup a local delicacy. To the Christians, the Black Bats are heroes defending their ancestral lands. They are spoken of with reverence. To Muslims, they are murderers.

Once the Pamona people were feared head-hunters. Today they are God-fearing Christians, with their headquarters in the picturesque highland town of Tentena, where the Central Sulawesi Christian Church has set up a crisis centre to help co-ordinate their “defence”.

Down on the coast is the enemy. The Muslims control coastal Poso town and much of the lowlands. But the lie of the land helps the Christian side, as does their traditional knowledge of its byways, plants and animals. The three-year Poso war peaked last year. Most of the victims were Muslims. Men who followed the army round the rivers and creeks weeks later picking up bodies counted more than 300 Muslim dead who were considered identifiable. The total was far higher, but how high is anyone's guess. Many had their heads missing. Poso's Muslims would not eat fish for months.

Christian losses were lower. According to the crisis centre, at least 37 died. Rinaldy Damanik, general secretary of the church synod in Tentena, estimates total Christian losses were probably around 100. Now the war is back with a vengeance, with well over a dozen dead this year. The cause is the death sentences handed down to three Christians for last year's killings. No Muslims have been sentenced to death for any of Indonesia's ethnic bloodshed. “*Jihad* [holy war] forces” from outside are joining in on the Muslim side, turning this into a true war of religion. Tit-for-tat attacks by each side on the Christian “red zone” or the Muslim “white zone” have become commonplace, with hundreds taking part in huge battles. Christians claim the paramilitary police have joined in on the Muslim side, using automatic weapons.

In the Muslim areas, long, flowing Arabian-style dress is increasingly common, as is the headscarf. In Tentena every house still standing has a cross prominently marked on its wall. Though it is surrounded by large swathes of Christian territory and is virtually impregnable on the shores of the giant Lake Poso, Tentena is also hemmed in. There are Muslims not only to the north, but also to the south, whence come virtually all supplies. There are no flights in or out of Tentena.

If a dog comes to your home, you will give him food. If a dog is treated like that, will you not treat a human even better? So say the traditions of the Pamona people. But now, driven out of the coastal areas their ancestors once possessed, the Christians of Poso district feel the guests have abused their welcome.

Historically, this part of Sulawesi was largely left alone by outsiders, until 1892, when the Dutch colonial government moved in to establish control. A strident missionary campaign followed. Today nearly all the descendants of the original inhabitants are Christians. But the Dutch presence also opened the door to Muslim migrants from other parts of Sulawesi. Being fishermen, they settled along the coast. After independence, the government in Jakarta moved in more migrants: Christians, Hindus from Bali, and many Javanese Muslims, who were given land to farm alongside the indigenous people.

The Poso war was first triggered by an argument about Christian youths drinking alcohol near the mosque in Poso town. In the background was a deep dispute about jobs for the boys in the local administration. Christians say an informal arrangement had existed to rotate the job of district head between the two groups. Muslims from other areas tried to stop that, to push the Christians out and place their own people in all the main posts. In corrupt Indonesia, that probably means that lucrative government aid and contracts would be directed to their people.

The ordinary Muslims paid the price. Most of their cocoa and coconut plantations are now going wild. Muslim refugees have horrific tales to tell of sons as young as nine being trussed up and led away, never to be seen again, by men in black masks and capes. The two sides fought with bows and arrows, spears and home-made guns welded together from bits of spare piping, deadly to a range of around 80 metres. Advent Lindo Lateka, the descendant of a former chieftain, emerged as the Christian leader and died on the battlefield. But his forces “won”. Or so they thought at the time.

Now Tentena is a virtual mini-state of its own, largely beyond the reach of Indonesian power. The police keep their heads down. The Christians distrust the local police and prefer to deal with the army, which they regard as more neutral. Christian youths openly wander round Tentena with their ramshackle guns and mount vigilante checks on cars coming in and out.

Like Aceh and the Moluccas, Poso is a problem with no obvious solution. Reconciliation has been attempted and failed. Ex-President Abdurrahman Wahid even came to witness a peace ceremony. A few months later it is all happening again.

Poso is not the only part of Sulawesi to have this delicate mix of Christians and Muslims. The entire island is a patchwork of Christian and Muslim areas, and a few mixed ones. If island-wide war has not happened yet, it is only because both sides are terrified of what religion has done in the Moluccas, just to the east.

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The cost of the intifada

Pain, unequally spread

Aug 9th 2001 | JERUSALEM
From The Economist print edition

AP

The Palestinians suffer most, but loss of confidence affects the region too

AP

Get article background

IN THE brutal slugging match that the *intifada* has become, there are few winners. Israeli makers of barbed wire and concrete blocks are doing a brisk trade. So is the makeshift industry servicing the checkpoints that have turned the occupied territories into an archipelago of barricaded towns and villages: car-washers, peanut-vendors and the small boys who, for a shekel, will ferry shopping bags past Israeli guns. But aside from the terrible toll in lives, the unrest is costing dearly in terms of livelihoods, hurting not just the Israeli and Palestinian economies, but all their neighbours' too.

As in the fighting, the pain is hardly equal. Palestinian incomes were a tenth of Israeli ones a year ago. Now they are a twentieth. “We are like a camel living on its hump,” says Rafik al-Natshe, who runs the Palestinian ministry of labour by fax from a training institute in Hebron, because he cannot be sure of getting to its Ramallah headquarters some 40km (25 miles) away.

Of the 1m people bottled up in the Gaza strip, four-fifths have fallen below the poverty line, compared with one-third before the *intifada*; more than half survive on emergency UN rations. Two-thirds of the workforce is idle (compared with one-fifth before), either because they cannot go to jobs in Israel, or because local businesses have closed for lack of supplies and markets. The West Bank, partitioned at gunpoint into some 60 islands, hardly fares better. Poverty has quadrupled to cover more than half the population, and well over a third are unemployed. The trip from Hebron to Ramallah takes less than an

hour along the bypasses built exclusively for Israeli settlers. For Palestinians it is a three-to-four-hour journey, punctuated by eight or more changes of transport and long walks in between, depending on how often Israeli soldiers bar the bumpy back-roads to which Palestinians are restricted.

The 28 hotels of Bethlehem, a town that lives from tourism, are lifeless shells. Hebron's crumbling old city is an eerie ghost town. The Israeli army has locked its 35,000 residents under a near-permanent curfew to “protect” the 500 armed Israeli colonists who live in their midst.

“Frankly, we are strangling them,” says an Israeli economist. Yet he does not believe the tactic will work. The Palestinians remain cushioned by strong families, by aid from abroad that may amount to some $500 a head this year, and by a gritty will to survive. The Palestinian Authority's 120,000 employees have taken pay cuts, but Arab money keeps the government afloat even though Israel refuses to transfer the customs revenues that used to provide two-thirds of its income.

The withheld funds, some $30m a month, help offset the increased cost of Israel's occupation. But this does not compensate for the halving of Israel's $2 billion-a-year trade with the territories, or the 50% plunge in its tourism receipts since the *intifada* erupted, or the slump in building caused by the cutting-off of cheap Palestinian labour. Israel's economic growth, a heady 6% in 2000, is expected to tumble well below 2% this year, its lowest level since the 1970s. Still, this represents little more than a pinch for an economy in which living standards are on a par with Western Europe's.

If Israeli productivity approaches German levels, this is largely because of the success of one sector. High-tech industries have accounted for a third of Israel's economic growth in the past decade. Now, inconveniently, this industry's global woes are adding to Israel's troubles. Damage from the *intifada* looks paltry next to the $63 billion in paper value lost in the past 18 months by the 100-odd Israeli technology stocks listed on foreign exchanges, a sum equal to more than half of Israel's GNP.

Of course, the losers were nearly all foreign punters. A glance at the booming suburbs of Tel Aviv, agleam with start-up factories, suggests that plenty of vigour remains from an economic high point just before the *intifada* began. Over $4 billion a year in aid from abroad does not hurt, either. Israel's high degree of globalisation is also a useful insulator. Half a dozen of its top companies, for example, are full-blown multinationals that make most of their money elsewhere.

As the unrest drags on, however, and as the world economy slows down, even Israel's robust economy is feeling squeezed. Property prices in Jerusalem, where Israelis and Palestinians often clash, have already fallen 20% since last year. Analysts attribute this year's 50% decline in direct foreign investment, and the withdrawal of $1 billion in portfolio investment, to world market factors rather than security concerns. But a successful industrialist notes that customers now refuse to come to Israel. People don't like to put their money where they themselves fear to tread.

Foreign investors' worries have already severely dampened neighbouring economies. Lebanon's government borrowed on a huge scale through the 1990s, largely in the hope that an approaching peace would allow it to reclaim its role as a regional service centre. Debt-servicing now eats up a ruinous 85% of its revenue, with no improvement in prospect.

Jordanian businesses bet on peace, too, spending over $1 billion on building hotels in the past three years. A 40% drop in western visitors means that most of these are either half-finished or half-empty. Jordan's top investment bank expects the country's economic growth this year barely to match its population growth of 3.3%. And although Syria and Egypt largely have their own administrative bungling to blame for their current economic doldrums, the general tension has not helped. Egyptian stock indexes, for example, are thudding along at all-time lows.

The cost of lost confidence is hard, if not impossible, to quantify. However, it is significant that Israel and all its neighbours enjoyed high growth in the early 1990s, when the 1991 Madrid conference and the subsequent Oslo accords had begun to make peace seem not just nearer, but inevitable. After 1996, however, even as the world boomed, all these countries started to slump. That was a year of terrorist strikes in Israeli cities and a new, hardline Israeli government under Binyamin Netanyahu, whose foot-dragging on Oslo began to destroy the general optimism.

The region's economies, all very distinct, barely trade with one another. Clearly, however, gloom as well as optimism is infectious. Now, with the Palestinians and the Israelis concurring about one thing only—that matters will get far worse before they perhaps get better—the gloom may spread even faster.

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Israel and the Greek patriarchate

The state backs off

Aug 9th 2001 | JERUSALEM
From The Economist print edition

AP

Who will succeed Diodoros?

What is Israel's interest in the new Greek Orthodox patriarch?

BYZANTINE is the only way to describe Israel's attempts to influence the election of a new Greek Orthodox patriarch of Jerusalem to succeed the late Diodoros. The election, by a synod of senior clerics, is set for August 13th.

On August 6th the government sheepishly informed the High Court that it was revoking its “irrevocable decision” issued in May to disqualify five of the 15 candidates competing for this venerable office at the head of the largest and oldest Christian church in the Holy Land. The justice minister, who signed the ban had apparently been got at by officials purporting to be acting in the national interest. Later he had to reverse it.

But whom were they trying to help or hinder? One of the five banned prelates, Irineos, metropolitan of Ierapolis, is thought to be favoured by the Palestinian Authority. But another, Timothy, metropolitan of Vestra, is considered close to Israel. Among the faithful—the Greek Orthodox patriarchate ministers to some 400,000 adherents in Israel, Palestine and Jordan—rumours abound of shadowy deals and double-crossings.

AP

Who will succeed Diodoros?

Since its establishment in 451, the patriarchate has accumulated some of the finest parts of Jerusalem. Its policy is to lease rather than to sell. The Israeli government is a major lessee. Relations have generally been excellent until this crude attempt at election-rigging. Senior Orthodox clerics condemned it as “a most unacceptable interference in the life of the patriarchate, the oldest church in the world.” Now that the minister has backed off, efforts to influence the election can resume their traditional modes of discretion and subtlety.

One group with little to say about the matter is the Palestinian flock in nearby Bethlehem. Caught in nightly exchanges of fire, to them ecclesiastical politics may seem remote.

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AIDS in Botswana

A new approach

Aug 9th 2001 | GABORONE
From The Economist print edition

AIDS-hit Botswana is trying free anti-retroviral drugs

BOTSWANA has the highest rate of HIV infection in the world: 350,000 of its 1.7m people have the virus that causes AIDS. Over a third of its young adult population, the most productive and the most sexually active, are worst hit. Well over half of those aged between 25 and 29 years have the disease. Every hour, says the government, a baby is infected. The overall rate is not slowing. Average life expectancy has fallen from 60 years to 40 and may drop to below 30 by 2010. Botswana's economy, an African success story, may stop growing at its current rate of about 5.5% a year and expand instead at under 2.5%, says the IMF. “We are frightened,” says President Festus Mogae, “Wouldn't you be frightened?”

Can Botswana beat it? Behaviour is changing, but slowly. To chip away at the stigma that surrounds the disease, some politicians have begun to take HIV tests in public at one of half a dozen new centres. But too few ordinary people opt for them. A mere one in ten of those who are infected knows it. The use of condoms is encouraged—one slogan advises, “Stay alive and condomise”—and the government says it gave out 12m of them last year. But studies suggest few are used.

Newspapers are full of advertisements warning against unsafe sex, and messages have been broadcast for so long that villagers call the illness the “radio disease”. But after 15 years of public-awareness campaigns to change sexual behaviour, the infection rate is still rising.

So now the government is trying a route unique in Africa: free anti-retroviral drugs. “It is probably a test case. This is the only developing country with an advanced, comprehensive approach,” says Donald de Korte, a Dutchman who heads the project. For five years, most of the drugs—which limit opportunistic disease, and make a patient less infectious to others—will be given free by Merck, a pharmaceutical company. An extra $100m (from Merck and the medical foundation started by Microsoft's Bill Gates) is to be spent on training nurses, education, more condoms and creating more hospital beds.

The hope is that the drugs will both help infected people and encourage everyone to change behaviour. Until now, people turned down HIV tests because no effective therapy was on offer. Why take a test, and risk the stigma of being known to be a carrier, if no treatment was available? But since the government said in February that it would provide drugs free to all residents, the testing centres have seen a boom in custom. As people learn of their infection—or lack of it—they may be more likely to change sexual behaviour. They may even begin to talk about the disease and how to manage it.

Botswana is relatively rich. Last year its GDP per person was over $3,500—vastly above the African average—and thanks to diamond exports it had foreign reserves of more than $6 billion. It also gets some AIDS-treatment drugs free. But even without the gifts, the $1-a-day cost of triple-therapy drugs for each patient is manageable.

Providing anti-retrovirals is only part of the solution. The country also needs a good health infrastructure, testing laboratories, lots of well-trained nurses and doctors. Once begun, anti-retrovirals must be taken for life. Infected mothers, who take them to avoid infecting their babies during childbirth, must also use powdered milk; breast feeding may pass on the disease.

Some Batswana are already getting free anti-retrovirals. Debswana, a mining company owned by the government and De Beers, which runs the diamond cartel, said in March that it would give anti-AIDS drugs to any employees who needed them, and to up to one wife per worker.

If it works, Botswana's example will encourage other countries in Africa to follow suit. Some will be reluctant. Most of sub-Saharan Africa lacks Botswana's wealth, health system, foreign assistance and

political leadership. And though the rates are high in Botswana, the sheer numbers of infected people are higher elsewhere. Slow-to-respond South Africa next door has at least 4m. The cost and logistics of handing out pills there are daunting. What would it take to have a similar approach in Botswana's southern neighbour, in five years' time? Mr de Korte says: “In South Africa, if we have no change in five years' time? It will already be too late.”

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Refugees

Flight into penury

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From The Economist print edition

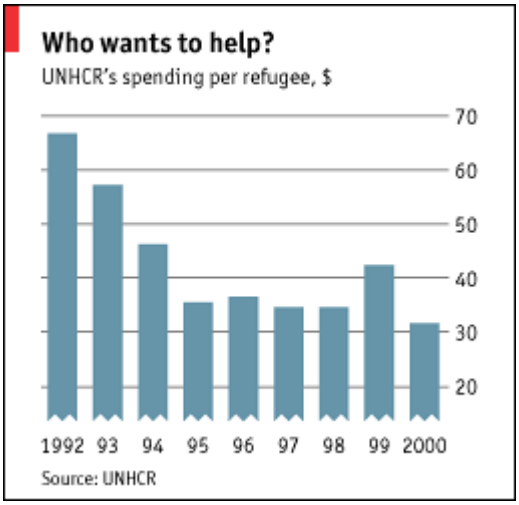
EPA

The UNagency for refugees is facing a cash crunch

REFUGEES may find themselves even worse off than usual this year. Faced with the prospect of a $150m budget shortfall, the United Nations High Commissioner for Refugees (UNHCR), which helps to look after more than 22m refugees and displaced people, has cut its 2001 budget by over $100m to $862m. It is shedding 800 members of staff and closing down nine offices, including seven in Africa.

Unlike the UN secretariat, which gets its money from mandatory government payments, UN agencies rely on voluntary contributions. The money for the UNHCR, of which 95% comes from governments, is rarely enough; moreover, it does not always arrive when it is most needed. So the agency usually just scrapes by, carrying over funds from previous years, or freezing its budget temporarily. But Ruud Lubbers, the former Dutch prime minister appointed to run it last January, has decided it must cut its coat according to its cloth.

By being a bit dramatic, Mr Lubbers wants to draw donors' attention to the agency's chronic shortage of money. He has embarked on a campaign to persuade rich countries that, for each of their citizens, they should contribute $1 to the refugees' cause. So far, few have done so.



His cup runneth not over

Over the years, the agency's “clientele” has expanded from refugees—those who flee across borders—to “internally displaced persons” (IDPs), who have been driven from their homes but have not crossed a border. The proliferation of wars, from Africa to the Balkans, has created soaring numbers of refugees and IDPs, and the UNHCR has had its hands full. Setting the $1-a-head target may bring minds to bear on the problem, but it is unlikely to raise much extra cash. Most industrialised countries are failing to meet UN targets for development aid, and the proportion of GDP they give to poor countries fell last year to the lowest level for years.

The UNHCR might do better to seek more private money. Private contributions, from individuals, companies and foundations, typically make up less than 5% of UNHCR's annual income. By comparison, the UN Children's Fund (Unicef) derives a third of its $1 billion budget from private sources. Its fundraising relies heavily on a network of national committees, some of them almost as old as the agency

itself. Active in 37 countries, these are chartered by Unicef to organise campaigns on its behalf; they have helped to make Unicef Christmas cards, first marketed in 1949, best-sellers. An army of movie stars and sports celebrities has been recruited as goodwill ambassadors to promote the agency and bring in the dollars.

Cynics may argue that it is far easier to raise money for children than for refugees, butUNHCR could do better than it does. It is hardly a household name. Its network of national associations has only six groups, understaffed and under-equipped. To become better known, it plans to spend $4m this year strengthening its existing associations, creating new ones and organising fundraising events. Angelina Jolie, a Hollywood actress, may soon bear the torch for the agency. But UNHCR greeting cards are not in prospect: the refugees do not want to be seen copying the children.

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Macedonia

War or peace?

Aug 9th 2001 | OHRID
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Even with a peace deal signed, the danger of war in Macedonia is acute

AP

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CONSIDERING the firepower, wealth and prestige of the international clubs they speak for—NATO and the European Union—the western negotiators who have been trying to bring peace to Macedonia are remarkably gloomy about their ability to ensure a happy future for one small European country. And whether or not the agreement initialled this week by Macedonia's Slav and ethnic-Albanian politicians wins broad approval, there are plenty of reasons for the cautious note being struck by François Léotard, a Frenchman who speaks for the EU, and his fellow mediator James Pardew, an American diplomat.

Even if a 3,500-strong NATO peacekeeping force is successfully deployed and relieves Macedonia's ethnic-Albanian rebels of some of their weapons—as is foreseen by a plan known as Operational Essential Harvest—there is enough hatred, mistrust and opportunism in the country to keep tensions strained, and guns sputtering, for a long time to come. Hence the warning this week from Mr Léotard that Macedonia had all the ingredients for an internal war every bit as bloody as the preceding wars that took up to 200,000 lives in various bits of ex-Yugoslavia over the past decade. Mr Léotard should know: he served as French defence minister during Bosnia's bloodbath in the mid-1990s.

The pessimists' two main arguments reinforce one another. One is the self-confidence of the ethnic-Albanian fighters of the National Liberation Army, who killed at least ten government soldiers in an ambush on August 8th, on the road between Skopje, the capital, and Tetovo, an Albanian stronghold. The other main ground for gloom is the tough stand being taken by some of Macedonia's Slav politicians—particularly the VMRO party led by Ljubco Georgievski, the prime minister, and Ljube Boskovski, who as interior minister oversees the police and several shadowy paramilitary organisations.

In the few days before this week's sudden escalation, the negotiations in Ohrid, a peaceful lakeside resort, had sparked some flickers of hope, with agreements sealed on issues that had hitherto been highly contentious. For instance, the two sides reached an understanding not only on the use of Albanian as an officially recognised language, but also on the even thornier issue of the police. Javier Solana, the EU's foreign-policy chief, triumphantly announced that from 2002 onwards the ethnic-Albanians' contingent in the police force would be in line with their share of the total population. That share is itself disputed: the Albanians say they amount to at least a third of the population, whereas the Slav Macedonians put them at no more than a quarter.

But the perkier message from the perpetually smiling Mr Solana was dampened by a fresh outburst from the prime minister and interior minister, who suddenly insisted that the handover of weapons, due to be overseen by NATO, must take place before any peace deal could be signed. Not so, insisted the weary mediators; disarmament and the ratification of a peace deal must work in parallel. In practical terms, in the best imaginable circumstances, this would mean that British, Italian, French, German and possibly Czech soldiers would set foot on Macedonia's scorching northern plains by mid-August, and Albanian rebels would start handing over Kalashnikovs just days

afterwards.

British officials were insisting this week that NATO's intervention would be pretty brief—one or at most two months—and would not proceed at all unless there was a durable ceasefire, and rock-solid agreement between Macedonia's rival peoples. But that will be elusive, to judge by the rancorous tone of this week's peace talks. After backing down on their demands for early disarmament, the VMRO hawks tried to throw in extra demands for constitutional change. And just in case peace-makers might be in any doubt of the serious nature of the rebels' threat to the country's stability, Mr Boskovski's special police units shot dead five members of an ethnic-Albanian rebel group discovered hiding in Skopje.

Neither should there be any illusion that a disarmament programme, even if eventually carried out, would spell the end of armed Albanian nationalism, either in Macedonia or in other bits of the southern Balkans. However many weapons they hand over, there is little to stop the fighters hiding their best equipment in the mountains on the Kosovan border, terrain they have controlled since February.

To an increasing extent, western diplomats and soldiers in the southern Balkans acknowledge that they have underestimated militant Albanian nationalism; and that hopes of co-opting or “taming” it—by turning a blind eye to smuggling or worse—were unrealistic. In Kosovo, in particular, the international protectorate's claim to be fashioning a law-governed, multi-ethnic state is wearing thin. Western governments had hoped that setting up the Kosovo Protection Corps, a notionally civilian force, would absorb the energies of the battle-hardened Albanian rebels who had fought in parallel with NATO to wrest the province from Serbian control.

But it has become painfully obvious that senior KPC men have been deeply involved in the armed uprising by ethnic Albanians against Macedonia's more-or-less pro-western, NATO-friendly government. In June, for example, the Bush administration published a list of people banned from entering the United States—and whose assets there were being frozen—because they were fomenting rebellion against Macedonia's government. Five on the list turned out to be top men in the supposedly respectable KPC. Hans Haekkerup, the Dane who governs Kosovo on behalf of the UN, insisted that the five should be suspended from the corps, although America was at first reluctant to share with him the intelligence on which their banning was based.

Administering Kosovo has always involved a series of delicate judgments about when to crack down on, and when to turn a blind eye to, the linked phenomena of ethnic violence, smuggling and other forms of crime. The deepening crisis in Macedonia suggests that some judgments have been wrong.

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Italy

The fruits of office

Aug 9th 2001
From The Economist print edition

Has Italy's prime minister found a legislative fix for his judicial problems?

Get article background

Reuters

Nice taste

DAYS before Italy's general election, Gianni Agnelli, the octogenarian honorary chairman of Fiat, the country's biggest industrial group, scolded the foreign press for “passing judgment on a potential prime minister, treating our voters as if they were the electorate of a banana republic”. On May 13th that potential prime minister, Silvio Berlusconi, won a handsome victory.

Last week the lower house of Italy's parliament, where Mr Berlusconi's coalition enjoys a majority of over 100, passed a bill, one of the new government's first, that deals with the crime of false accounting. The bill would shame even the voters of a banana republic.

If it is approved in September without amendment by the upper house, the Senate, where Mr Berlusconi's coalition has a smaller majority, and is then signed by Carlo Azeglio Ciampi, Italy's president, the bill will become law. In that event, the verdict in two of the three criminal trials in which Mr Berlusconi is currently a defendant would be irrelevant. Whether innocent, as he maintains he is, or guilty of the alleged offences, Mr Berlusconi, who is Italy's richest man, would be cleared.

How come? Reform of Italy's false-accounting laws has been discussed for some time. The magistrates who launched the *mani pulite* (clean hands) investigations into corruption in 1992 have used the current legislation to prosecute a string of businessmen, including Mr Berlusconi. The previous government introduced a modest bill to reform the false-accounting laws, but parliament did not find time to enact it before the election. Mr Berlusconi's government has now presented this bill again—but with crucial amendments.

One of these means that the bill now, in effect, decriminalises most offences of false accounting in private companies. This is because prosecutors will not be able to bring charges except in response to a complaint from a party—a shareholder, say, or a creditor—who is able to show damage as a result of the alleged fraud. Second, prison sentences, currently up to five years, are greatly reduced. Third, as a direct result of this reduction, the statute of limitations comes into effect much earlier. At present, a defendant can be convicted of an offence of false accounting for up to 15 years after the offence was committed. Under the bill, this period is cut to a maximum of seven years and six months.

Two parliamentary committees drafted and passed the new bill. One of these was the judicial-affairs committee, which is chaired by Gaetano Pecorella, a member of parliament for Forza Italia, Mr Berlusconi's party, who is a practising criminal lawyer. Mr Pecorella backed the crucial amendments, which were introduced at the committee stage. He is also, astonishingly, currently defending Mr Berlusconi against charges, which Mr Berlusconi denies, that he bribed judges. So is Niccolo Ghedini, another Forza Italia deputy who is a practising criminal lawyer sitting on the same parliamentary committee.

The two criminal trials in which Italy's prime minister is currently a defendant on charges of false accounting involve private companies that he owns. The first relates to alleged irregularities in the purchase of a footballer by AC Milan, a football club he owns, and the second to alleged falsification of the accounts of Fininvest, his main holding company. He also faces further possible charges of

falsification of the consolidated accounts of Fininvest. All these alleged offences of false accounting relate to 1993 or before. So, under the new bill, if enacted, they would be covered by the redefined statute of limitations. Under Italy's penal code, this extinguishes the crime.

In a separate legislative step last week, the Senate approved an accord that would establish guidelines for judicial co-operation between Italy and Switzerland. The accord had been bogged down in parliament for the past three years. Under it, evidence obtained by Italian magistrates from their Swiss counterparts may be challenged in Italian courts if it has not been obtained in accordance with procedural rules that apply in international treaties. The accord is subject to ratification by the lower house later this year.

In Mr Berlusconi's current trial for corrupting judges, the alleged trail of money from Mr Berlusconi via intermediaries to the judges relies heavily on evidence obtained from bank accounts in Switzerland. If the accord is ratified, and if Mr Pecorella and Mr Ghedini are able to find procedural defects in the way evidence was gathered in Switzerland, Mr Berlusconi may be off the hook on these charges as well.

This autumn, the parliament may also debate a governmental plan to resolve Mr Berlusconi's conflicts of interest. Under it, as proposed (but rejected by the opposition), the speakers of the two houses would name a three-person watchdog to point out legislation that might lead to such conflicts, for him or other ministers.

Mr Berlusconi failed in an attempt during his first spell as prime minister in 1994 to pass a law, known to its foes as the *decreto salva ladri* (save-the-thieves law), that would have let off people under investigation by the *mani pulite*. This time, the proposed false-accounting legislation is much more likely to become law. Bananas?

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German immigration

Help wanted

Aug 9th 2001 | FRANKFURT
From The Economist print edition

Germany's interior minister wants to loosen immigration controls

EPA

Come on in, says Schily

UNEMPLOYMENT is up, and a general election is little more than a year away. An odd moment for a politician to offer a welcome to foreign workers? Not, these days, for Otto Schily, Germany's interior minister. Once Mr Schily said, “The boat is full.” Now he wants more hands in the engine room. Employers complain that Germany's unemployed are short of skills; and the proportion of retired people in the population is set to rise sharply in the coming decades. It seems that only foreigners by the hundreds of thousands (qualified ones, please) can do the job.

Mr Schily's plan broadly follows the recent report of a commission he set up, headed by Rita Süssmuth, a parliamentarian from the biggest opposition party, the Christian Democrats. Should his proposal become law, Germany will offer immediate entry, for an indefinite time, to highly qualified foreign workers. Other hopefuls will be awarded points according to criteria such as age, qualifications and knowledge of German, and if they score enough, in they too will come. They will have to follow an “integration course”, learning German language and history, or risk losing their work permits. In principle, this marks a big change. In Germany, the norm has been to accept as permanent immigrants only people with strong blood ties. Mr Schily's points system has been borrowed from Canada, a country with a history of selective economic immigration. His version may be tight: his draft calls it an “additional, optional instrument” that will apply in the first instance “only to a very limited number of immigrants.”

Mr Schily would like his plan to become law next year. But backing from his own party, the Social Democrats, and its junior coalition partner, the Greens, would not suffice. The government is in a minority in the upper house, and he will need some votes there from the Christian Democrats and their Bavarian sister party, the Christian Social Union. So, at the risk of irritating the Greens, he has already taken some steps towards a deal.

Immigrants admitted under the points system will be allowed to arrive with their children. But if they want these to follow later, there will be an age limit: up to the child's 12th birthday, not after (as against the 18th birthday proposed by the Greens or the tenth by the Christian Democrats).

So far, the right-wing parties are hesitant. But Mr Schily faces other judges too, the foreigners he is wooing. Cem Özdemir, an MP (of ethnic-Turkish descent) who speaks on home affairs for the Greens, says that Germans have long had the false idea that “in the third world everyone sits on packed suitcases”, dreaming of living in a German “paradise”. The government's “green card” scheme, intended to attract up to 20,000 computer experts, especially from India, has not been a big success. Many people preferred America. “We need to make ourselves more attractive,” says Mr Özdemir. Still, Mr Schily is taking the first step.

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France

Watch your wallet

Aug 9th 2001 | PARIS
From The Economist print edition

Crime is the voters' biggest worry these days in France

EPA

Light fingers in the city of light

WITH practised ease, the pickpockets, mere children from Eastern Europe, yet again relieve the tourists, cramming into the Metro on their way to the Louvre, of cash and credit cards. With equal efficiency the teenage mugger from the housing estates round Paris spots a businessman in mid-conversation and snatches away his cell phone. Meanwhile the duo on a motorbike weave through a traffic-jam looking for an open car-window and another handbag to grab.

Are these isolated incidents of the kind that occur in any big city? Of course, but unhappily not as isolated as before. According to police figures, thefts involving violence in public areas were up by 41% in the first half of this year compared with the first half of 2000, crime in the Metro by 25%, pickpocketing and handbag-snatching by 13%. True, fewer cars were stolen and fewer banks hit by armed robbers. But overall the capital's crime figures were 7% up. Nationally, the rise was almost 10%.

No wonder crime has become the number-one worry of the voters. President Jacques Chirac recently advocated “zero tolerance”, New York-style. As, at first sight, well he might: last year, according to one report, France overtook the United States in criminality, with 4,244 crimes per 100,000 people compared with the American figure of 4,135.

Or did it? Most countries' crime statistics are open to large questions; the director of criminal studies at France's national research centre has strongly criticised the methods used to make the comparison with America. France's police, seeking higher pay and more members, have an interest in raising public fears (a police union earlier put the increase in crime at 12%). They are keen too to show the ill effects of the greater difficulty they have keeping suspects in custody, after a recent strengthening of the presumption of innocence.

No matter. The political question is how to lower the figures. The government has promised an extra 3,000 police. But there are already 146,000 national police answerable to the interior ministry, and 101,000 gendarmes, controlled by the defence ministry. Add 13,000 municipal police, employed (according to local budgets and political tastes) by various town and village councils, and France is not obviously underpoliced. A better step might be to encourage the various forces to collaborate: the gendarmerie, responsible for the countryside and small towns, and the national police, responsible for towns of 20,000 inhabitants and more (which is where 75% of all crimes take place), are notoriously jealous of each other.

One other answer, judged legal for the first time in France last month, is to impose night-time curfews on the young and potentially delinquent. Already Orleans, some 100km (65 miles) south of Paris, is banning children under the age of 13 from roaming the night-time streets of its “difficult” areas. On the south coast Antibes, Cannes and Nice are applying the idea to tourist spots.

Not all adults are happy. France's poor suburbs indeed breed delinquency, and the delinquents are becoming more mobile. But, as Bertrand Delanoë, the Socialist mayor of Paris, argues, curfews stigmatise some areas and so have a “segregationist logic that threatens to worsen the problems they are supposed to resolve.” Moreover, he points out, plenty of laws already exist that authorise the police to take idle youngsters off the streets at night, for their own and everyone else's protection.

Nor, he might add, is crime a solely dusk-to-dawn affair. Even at midday in this “city of light”, keep an eye on your handbag, your wallet, your credit cards and especially your mobile phone.

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Women in Spain

The usual amount

Aug 9th 2001 | MADRID
From The Economist print edition

Spanish women are better treated than before—but they still have a way to go

WALK into many a Spanish bar and you will find this admonition among the proverbs inscribed on the wall: *La mujer en casa, con la pata quebrada* ("Keep the woman at home, with a broken leg"). The advice is often followed. According to Miguel Lorente Acosta, a doctor who teaches medical law at Granada University, more than 22,000 cases of domestic violence against women were reported last year compared with 17,500 in 1997. And that—reported in his book grimly entitled *"Mi Marido Me Pega Lo Normal"* ("My husband beats me the usual amount")—is just the tip of the iceberg.

The figures do not prove that cases are rising, but that women are more ready to report them. The issue is now on the political agenda. Last year Jose Bono, the socialist premier of the Castilla-La Mancha, proposed publishing a list of guilty men, and the central government has promised an extra 13 billion pesetas ($68m) for prevention and help for victims. Even so, says Dr Lorente, many case files are conveniently "lost" by the largely male police: 88% of them in 1990, still 43% a decade on.

The role of women in Spanish society has changed fast since the country became a democracy after General Franco died in 1975. He had swept away liberal reforms introduced in the 1930s, when Spain was a republic. For women specifically, these included a benevolent divorce law and certain property rights. In those days many women played a big part on the left, often fighting side by side with men in the pro-Republic militias during the 1936-39 civil war. But after it the new regime, for the most part applauded by the church, put them back in the home as wives and mothers, with divorce forbidden and working outside frowned on.

Change began in the 1960s when Spain opened up to tourists. Faced with competition from their free-wheeling Nordic sisters, Spanish women "declared war on them, on men and on their elders", in the words of Lucia Graves, author of "A Woman Unknown", which recounts her life as an Englishwoman married to a Spaniard at the time. That aggressive self-assertion continues.

Not wholly successfully. At universities, women students now outnumber men. A typical couple has one or two children these days, a far cry from the days when families of eight or ten were common. But Spanish women still face the problems of their sisters in Northern Europe. Their progress at work is often blocked, their pay often lower than men's. Jose Maria Aznar, Spain's centre-right prime minister, had four female cabinet ministers in his first term of office, three now—but an entirely different three. *The Economist*'s correspondent is frequently the only woman at press gatherings with businessmen or officials. And there is precious little "sisterhood" among Spanish women—though last year women's groups did join forces to seek a ban on a book by one of Spain's foremost Muslim leaders in which he set out ways for the faithful to beat their wives without leaving external marks. That reflected the new complication that has arisen with the arrival of immigrants from Latin America and North Africa.

The fight against domestic violence is bringing an ugly backlash. The number of domestic murders has increased: from 33 in 1997 to 47 in 2,000 (or 68 that year, in the view of women's groups). And the provocation is often that the victim had reported her aggressor's earlier mistreatment. Another Spanish saying continues to ring true: "I killed her because she was mine, and if she were to rise again, she'd die."

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Charlemagne

Anatoly Kinakh

Aug 9th 2001
From The Economist print edition

Ukraine's smooth new prime minister looks unlikely to stop the rot

Get article background

STARTLING orders are being issued. Ukraine must integrate fully in the world economy. There must be democracy and market reform. Both must be rooted in civil society, with human rights, freedom of speech, the rule of law and public control of the state. The country needs more small businesses and a stronger middle class. It also needs open government, which citizens can scrutinise on the Internet.

Hang on a moment. Is this Sweden? Or is Anatoly Kinakh really talking about hapless, impoverished Ukraine, plagued by cronyism, incompetence and authoritarianism, notorious for political murders, murky scandals and corruption? Indeed he is. Whatever the shortcomings of Mr Kinakh's new government, you can't fault its ambitions, particularly in the PR department.

The difference extends beyond propaganda, though. Start with the atmosphere in the prime minister's office. Mr Kinakh's predecessor, Viktor Yushchenko, was lively and likeable, but chaotic. Appointments might run four hours late by the end of the day or not happen at all. His waiting-room swarmed with nervous supplicants. Piles of papers covered every flat surface. His staff included opportunists and oddballs. Mr Kinakh's style could hardly be more different. He and his aides radiate a slightly chilling self-discipline. Punctuality reigns. Decisions are made quickly and with little faffing around—or even discussion.

The first results since he took office in late May are mildly encouraging. With the formerly deadlocked political system now working smoothly, parliament has passed some long-awaited laws, including a new criminal code. The government eagerly seeks advice on improving corporate governance. Tedious registration and insurance requirements for foreigners have gone.

But it will take more than fine words and quick fixes to dispel the scepticism about Mr Kinakh, and Ukraine generally. He has taken over after a disgraceful year in the country's short history, marked by a botched investigation into the murder of a journalist, by the cynical use of state power against the opposition, and by the leaking of bugged conversations that made the country's leaders sound like a bunch of foul-mouthed thugs.

The outside world would love it to be different. Ukraine and its 50m people are important for Eastern Europe's future. With good government and a bit of luck, it could be a stable, prosperous neighbour for the European Union. Yet it risks becoming a cesspit of poverty, crime and disease. Foreign policy is shaky, too. Sometimes Ukraine flirts with NATO, sometimes with neutrality; sometimes it seems fated to become part of a new Russian empire. Ten years of generous western aid have fostered corruption more than change.

At first sight at least, Mr Kinakh looks an odd choice to sort all this out. Originally a shipyard engineer, his last job was running the industrialists' association, a stronghold of Ukraine's crony capitalism. His most obvious qualification for the prime ministership was that he was unobjectionable, as well as being loyal to the president, Leonid Kuchma—which others might consider a dubious recommendation. Mr Kuchma, and officials and tycoons close to him, are to blame for many of the country's ills. They sniped at, then ditched, Mr Yushchenko, who was strongly backed by the West and popular with Ukraine's long-suffering people. One of his leading ministers, Yulia Timoshenko, trod on some sensitive toes by trying to reform the energy industry. She was fired, briefly jailed and now heads the opposition.

It is possible but unlikely that Mr Kinakh marks a sharp break with this dismal past. He argues that the

powerful interests that used to block reform have changed their minds. There is now a “critical mass” for legality, openness and honest competition. Certainly, some changes are afoot in Ukrainian business. As in Russia, managers who used simply to loot their companies are thinking a bit more long-term. But there is no change of heart in greedy bureaucracies such as the customs service. Mr Kinakh smoothly concedes that there are lots of problems—and smoothly gets back on message. Change, he argues, is irreversible. Reform of the bureaucracy is just a question of time. Fighting corruption means raising public-sector salaries (his own is about $450 a month). Ukraine must join the WTO as soon as possible, to help make Ukrainian business more competitive.

When charity meets scepticism

For sure, Mr Yushchenko's two years in office laid useful foundations. According to (questionable) official figures, the economy, having shrunk by half after the Soviet collapse, is growing at a spanking 10% a year—much faster even than oil-rich Russia's. But Ukraine's lucrative and murky energy industry in particular seems to be slipping back to its bad old ways.

As for politics, the doubts overwhelm. Mr Kuchma and his pals are practised and ruthless in abusing power to keep it. The rectors at Ukraine's universities, for example, are told to send their students to official demonstrations and to keep them away from anti-Kuchma ones. Electoral fraud is widespread. The main state-run television channels virtually ignore popular figures such as Mr Yushchenko and Mrs Timoshenko. The gap between Mr Kinakh's noble ambitions and Mr Kuchma's habits will widen once campaigning starts next month for the general election in March. The authorities show no sign of tolerating a proper opposition.

Mrs Timoshenko says Mr Kuchma's model is Turkmenistan, an ex-Soviet police state in Central Asia with a bizarre presidential personality cult. That may be too harsh. But it is a fair bet that he is less interested in seeing Mr Kinakh engage in thorough reform than in managing Ukraine more smoothly, improving its image and making some changes that will not hurt the rich and powerful. Perhaps things could be worse. Like Russians, many Ukrainians just want some stability—even as their country rots, the talented leave and the gap with the rest of Europe grows.

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Northern Ireland

History or bunk?

Aug 9th 2001
From The Economist print edition

AP

At the beginning of the week, the peace process seemed to be taking a leap forward. By the end of the week it was teetering

Get article background

"HISTORIC" and "important" said the Irish and British governments when the body charged with overseeing the decommissioning of terrorist guns said the Irish Republican Army had explained how it would put its arms "completely and verifiably beyond use". Announcing the breakthrough on August 6th, John de Chastelain, the Canadian general who heads the body, said he was satisfied that the proposal initiated the process of decommissioning. On August 9th, the IRA confirmed it had agreed a scheme to decommission its weapons, but implied that the offer might be withdrawn if it was not taken seriously.

That the IRA was prepared to say anything at all about getting rid of its guns is indeed progress. But, upon examination, the announcement seemed less momentous than advertised. General de Chastelain gave no details of the method to be used for decommissioning, nor when it would begin. The move began to look like a scheme cooked up by Britain's Prime Minister, Tony Blair, Ireland's Taoiseach, Bertie Ahern, and Sinn Fein, the IRA's political wing, to boost the stock of David Trimble (above). Mr Trimble, the Ulster Unionist leader and the main man on the unionist side pushing the peace process, announced in June that he would resign as first minister of the Northern Ireland Assembly unless there was movement on decommissioning. His resignation is due to come into effect on August 12th.

In any event, unionists were unimpressed. Jeffrey Donaldson, an Ulster Unionist hardliner, dismissed the announcement. Even Mr Trimble did not seem to think that it went far enough. On August 8th, he said that the Assembly should be suspended unless the IRA went further. "Even at this late stage," he said, "the republicans can still save the process and save the Assembly by acting. But if they don't act, it is they who have put the institutions at risk."

With the peace process stuck once more in argument, and with tensions higher after a bomb blamed on the splinter Real IRA exploded in London on August 2nd, the British government was faced with the problem caused by Mr Trimble's resignation—what to do about the Assembly. Unlike most Northern Irish deadlines, the August 12th one is written into legislation, and therefore immutable.

As *The Economist* went to press, one of two outcomes seemed likely. Mr Trimble said that he wanted the Assembly to be suspended: he cannot rejoin the government unless decommissioning actually starts. The British government seemed to favour that option too: it hopes that after a summer break tempers might have cooled and the IRA's decommissioning scheme will progress in a way that begins to wear down or

reduce unionist suspicion.

The alternative—which Sinn Fein favours—would be to dissolve the Assembly and call new elections, which would probably be held in October. That course would have the advantage of restoring legitimacy to the rather shaky institutions set up by the Good Friday Agreement of three years ago, and the disadvantage of increasing the power of Mr Adams and the fire-and-brimstone unionist, the Reverend Ian Paisley, at the expense of their more moderate counterparts, the nationalist John Hume and Mr Trimble. The idea of Mr Paisley and Mr Adams as first minister and deputy first minister is almost surreal.

The rise of the extremists is, ironically, a consequence of the peace process. On the unionist side, this is because compromise has always splintered the movement. Today's Ulster Unionists are the remnants of the monolithic party which governed Northern Ireland for 50 years. Hardliners have always been alert for signs of weakness in unionist leadership. Mr Trimble's protracted armwrestling with republicans has allowed Mr Paisley to denounce him as a traitor and a dupe.

On the nationalist side, Mr Hume is recognised as one of the main architects of the peace process. He has outshone the rather lacklustre politicians who have dominated Northern Irish politics, and turned himself into an international figure as the leader of the moderate nationalist movement he did so much to shape. But Mr Hume is 64, and the SDLP has an ageing membership, worn by the long years of violence. Mr Adams is 12 years younger, and has been a similar force for reconstruction inside the republican movement. He leads a young and vigorous party, which treats parliamentary politics with the enthusiasm of a novice.

Most important, Mr Adams has guns behind him, and Mr Hume does not. By focusing, as it had to, on disarming terrorists, the peace process has kept the spotlight on Sinn Fein and the IRA. The nationalists who were already committed to peaceful means have been sidelined.

In the general election in June, for the first time, Sinn Fein won more votes than the SDLP. The election left the four main parties bunched tightly together. The UUP is still at the top, with 26.8% of the total vote. The DUP gained ground, to replace the SDLP as the second largest party, with 22.6% of the vote. SF's share of the total was 21.7%, the SDLP's 21%. The betting is that, if another election were called, the drift in the peace process since the general election would benefit the DUP and SF and worsen the UUP and SDLP positions.

How bad for peace is the moderates' loss of ground? Not, perhaps, as bad as might first appear. For the extremists are not the people they once were. That is most obviously true of Sinn Fein. The IRA's political wing is now so wholly committed to politics rather than war that its main argument with the UUP is over the unionists' refusal to sit with SF's ministers in meetings with the Irish government. What's more, SF knows full well that its strength is the result of its commitment to peace. If that weakens, so does its power.

It is harder to draw much comfort from the growing clout of the DUP. Mr Paisley's entire political career has been devoted to opposing any unionist move towards accommodating nationalists, and he has the scalps of previous unionist leaders to prove it. Yet even the DUP, these days, accepts that Northern Ireland's future involves some sort of power-sharing. Peace has not come to Northern Ireland, but the process of trying to bring it about has changed the place forever.

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About sponsorship

BT

Out of the loop

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Bids for bits of BT are showing up the company's failure to define a strategy

ITS debt crisis may be behind it, but BT's strategy—or lack thereof—is once again under scrutiny. Over the summer, the combination of a rights issue and the sale of various minority stakes in overseas operators has reduced its debt from £30 billion ($42 billion) to around £17.5 billion. It has announced plans to spin off its wireless arm, BT Wireless, leaving behind a rump fixed-line business, Future BT ("Legacy BT is more like it," says a cynical observer). But now that the fuss over its debt has died down, the new focus of speculation is two offers made recently for bits of BT's infrastructure, which have called the firm's strategy into question.

The first bid, from a consortium called Earthlease, consisted of an offer of £8 billion for BT's "local loop"—the 28m pairs of copper wires that run from its telephone exchanges into homes and offices. A rival bid came from WestLB, a German investment bank, which offered £18 billion for BT's entire fixed-line infrastructure, including exchanges and long-distance lines. In both cases, BT would keep its existing customers, but would pay to use the network to provide services to them. BT has rejected Earthlease's offer, and is thought to be highly unlikely to accept WestLB's. Should it have said yes?

The argument is finely balanced. On the "no" side, both bids are regarded as too low; valuing the local loop is difficult, but £25 billion is widely thought to be nearer the mark for the whole network. Yet even at a higher price, selling off the infrastructure does not make sense, say sceptics, since the local loop in particular is regarded as one of BT's most valuable assets. Mike Williams, an analyst at Deutsche Bank, worries that if BT simply became a retailer, it would be unable to balance pricing pressure with ability to manage its costs, and would get squeezed.

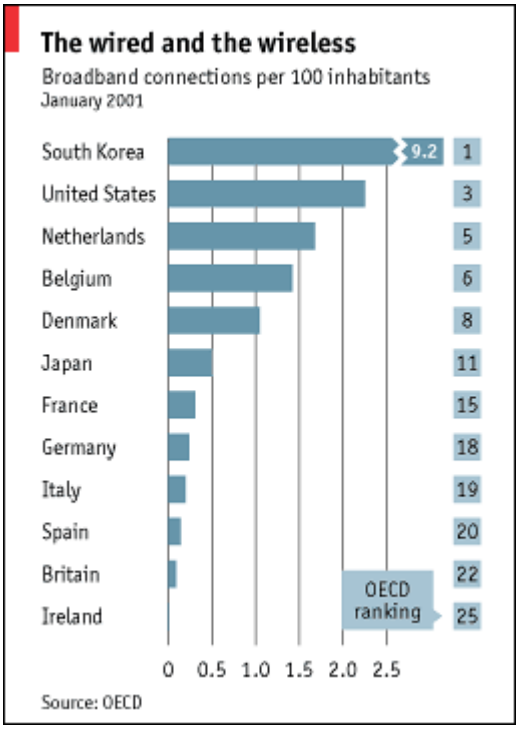
A broader, but unspoken, objection is that selling off the infrastructure would let competitors in, since they would then be able to offer services over the network too. BT is already supposed to allow third parties access to its local infrastructure—so-called "local-loop unbundling"—but has done an excellent job of ensuring that, in practice, very few lines have been unbundled. Last year, 40 operators expressed interest in using unbundled lines to offer services such as broadband Internet access and video. But BT's foot-dragging, together with the difficulty of raising capital, means that most of these operators have dropped out. So far, BT has unbundled a grand total of 146 lines in the whole country.

Largely as a result, Britain has by far the lowest take-up of broadband Internet access of any of the G7 nations, and is 22nd in the OECD—behind Portugal and the Czech Republic. BT's strategy seems to be to wait until all of its would-be competitors have given up, at which point it will have the market for sexy services such as broadband Internet access to itself. BT denies this, of course, and blames a lack of consumer demand.

The chief aim of the Earthlease and WestLB bids is to enable real unbundling to go ahead. Unlike BT, a company that owned just the infrastructure would clearly have an incentive to get as much use out of it as possible, by making it available to new operators to provide all sorts of new services. That said, those in favour of a sell-off point out that there are a number of ways in which BT would benefit.

For a start, BT gets a very low return on capital employed in its local loop: just 0.2%, according to figures in its most recent

report to Oftel, the telecoms regulator. So selling infrastructure should appeal to BT shareholders. It would also get the regulators off BT's back, since it would no longer have an infrastructure monopoly. EU regulations mean that unbundling will have to happen eventually anyway; by selling off its infrastructure now, BT would raise lots of cash to spend on developing new services. Given the current financial climate, competitors will find it hard to raise money, giving BT a head start.



What does BT's lack of interest in selling its infrastructure reveal about its strategy? The bids for the infrastructure have prompted some analysts to suggest that rather than selling its infrastructure and becoming a pure service-provider, it would make more sense for BT to sell its retail operation and concentrate on being a pure infrastructure provider (perhaps cancelling the wireless spin-off, too). BT has proposed splitting its infrastructure and retail operations into separate divisions, but seems to want to retain control of both.

It comes down to this: is BT's core asset its wires, or its customers? Choosing the former is safer, the latter more difficult, but with more scope for long-term growth. The speculation about which of these routes the company should take—and the fact that its current plan seems to be to do neither—is symptomatic of BT's failure to define its strategy. BT seems to be suffering from managerial paralysis. Either that, or its refusal to sell its infrastructure stems from a desire to continue as a lumbering, dinosaur-like monopoly, and to put off having to face real competition for as long as possible.

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Victorian music halls

Beer and opera

Aug 9th 2001 | LEEDS AND LONDON
From The Economist print edition

Victorian music halls outraged 19th-century moralists, but are exciting modern artists and impresarios

DESPITE all the drunkenness, obscenity and prostitution, the Victorian music hall realised the dream of today's cultural gurus. It achieved that elusive combination of mass appeal with a cutting edge, admitting no distinction between high and low culture. That partly explains why the few music halls that have survived are now attracting the attention of performers and conservationists.

At their zenith, there were hundreds of music halls across Britain, thronged with the working poor of London and the newly industrialised cities of the north. They evolved when entrepreneurial landlords, exploiting the popularity of impromptu sing-alongs, started hiring professionals to perform in back rooms. In the 1840s, the landlords began to build extensions (sometimes very grand), to accommodate the crowds. The income came largely from drink sales, and many music-hall songs mocked the abstinence and prudery of the Victorian middle classes. Popular themes included drink (a salvation), marriage (a disaster), work (a curse) and (even then) the caprices of public transport. But the halls also offered opera, drama and a variety of other distractions.

By the 1890s, though, they had become victims of their own success. They aroused the righteous indignation of members of the temperance movement, who set up less degenerate “coffee music halls” (which didn't last). Theatres lobbied against their rivals, which were beset by new licensing regulations. The entrepreneurs started cleaning up their acts to attract higher-class patrons. Most of the grand music halls have since been demolished, bombed, or converted beyond recognition.

A few, though, survived. The splendid City Varieties, in Leeds, has been in constant artistic use. Built above a pub in 1865, it could once pack in 1,500 revellers; now it accommodates 531 in greater comfort. The patrons of Hoxton Hall, in London, were once lubricated by a basement bar, and entertained by trapeze artists and performing dogs. In 1879, it was bought by temperance campaigners. It now hosts arts-education programmes, as well as some music-hall revivals and experimental theatre.

Alongside these two, several defunct music halls are being reclaimed as places of entertainment. The Malt Cross in Nottingham, which first opened in 1877, was restored in 1998. The Britannia in Glasgow, opened in 1860, was once the heart of a four-storey Victorian theme park, boasting a basement zoo and a freak show. It functioned until 1938, when it was cut in half by a false ceiling, with the lower part used for storage and the top half left to rot. Conservationists have recovered steel rivets that were hurled at unsatisfactory performers, and a curious quantity of men's fly buttons, justifying the Britannia's 19th-century reputation as a hotbed of vice. The aim is to reclaim it for exhibitions and performances.

The most dramatic rejuvenation has occurred at Wilton's Music Hall, hidden down an alley in London's East End, which was built behind a pub in 1858. Divas once raced over from the Covent Garden opera house to perform their arias. Nevertheless, when some local Methodists attended a performance they “prayed that god would break the power of the devil in the place”; and in 1885, they took it over. After they left, Wilton's fell into serious disrepair.

In 1999, Broomhill Opera moved in. The quirky programme of opera and musical theatre—a reasonable approximation to that of the 1860s—has been a roaring success. Local residents pay what they can. In an age when the “high” and “low” arts, and their audiences, have become polarised, the sweaty, bawdy Victorian music hall could point the way to a more inclusive artistic culture.

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Refugees

Green-eyed in Glasgow

Aug 9th 2001 | GLASGOW
From The Economist print edition

Reuters

Poverty and asylum-seekers are an explosive mix

TWO years ago, around 100 refugees fleeing the war in Kosovo were welcomed to Glasgow and showered with hospitality, as they were in many other British cities. Politicians were anxious to be photographed with them. Charities raised money to provide them with food and clothing. Now the city has about 5,000 refugees from a myriad of nations. And the mood has turned nasty.

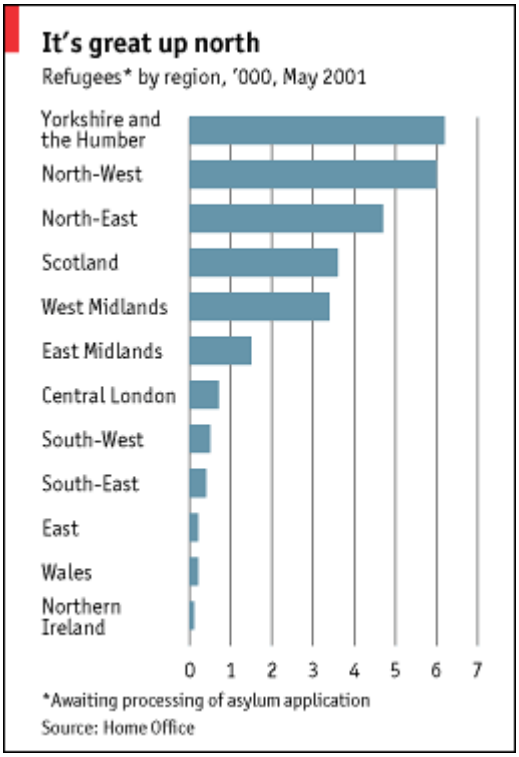
On August 5th, a 22-year-old Kurdish refugee was murdered by two white youths while walking home from an evening meal in the city centre. Two days of protests followed. Refugees complained that the authorities were not protecting them; locals that the refugees were being pampered. On August 7th the government decided it would be best to send no more refugees to the inflamed part of Glasgow just at the moment.

But that, and more alert policing, did not stop another young refugee from Iran being stabbed this week. Efforts to calm things down were not helped when the *Daily Record*, a big-selling Scottish tabloid, claimed on August 8th that the murdered Kurd was not, in fact, an escapee from political oppression. He was, the newspaper said, a fruit-and-veg seller who had come from a poor part of Turkey to try to make a better living in Britain.

What has changed? Most obviously, the numbers of refugees being sent to places like Glasgow has soared. In April last year, faced with a doubling since 1998 in the number of people claiming asylum (to about 100,000 in 2000), the government decided that new arrivals should be dispersed around the country to ease pressure on housing in London and the South-East.

Exactly how many refugees are currently scattered about Britain is hard to work out. The Home Office says that at the end of May there were 27,300 refugees waiting for their asylum applications to be processed. Since the start of 1999, 24,600 people have been given asylum, and another 24,800 have been allowed to stay while they wait. With their relatives, that means there are perhaps 110,000 refugees of one sort or another who have arrived in Britain in the last two-and-a-half years.

Most of these people have been sent to the Midlands, the north of England and Scotland, where the government reckons that there are about 700,000 empty houses. These are mainly council-owned properties and, not surprisingly, are almost all in poor city areas.



The problems in Glasgow flared in Sighthill, an area whose housing is comprised almost entirely of council-owned flats in low- and high-rise blocks. When there were just 100 Kosovan refugees, there was little problem. But the approximately 1,500 refugees now there are, it seems, too much for some locals.

While there is some racial tension, much of the problem stems from the poverty that afflicts the locals and refugees alike. Locals, who are either unemployed or poorly paid, have seen trucks turn up at refugees' houses and disgorge free carpets, furniture and other household necessities. Well-meaning charities supplying second-hand washing machines and the like have unwittingly stirred more resentment. Refugee organisations add that the spending vouchers that the government now gives asylum-seekers instead of money identify refugees to resentful eyes, strengthening suspicions among locals that they are spongers.

Glasgow Council insists that the refugees have been given no more than would, say, a local woman being re-housed to escape domestic violence. But that cuts little ice with some: on the night after the murder, around 100 Sighthill locals protested about what they claimed was preferential treatment for refugees.

To be fair, the authorities have not ignored the need to build bridges between residents and incomers. In June, Strathclyde police organised a festival in Sighthill featuring pipe bands, African drummers, and Chinese and Kurdish dancers, which was attended by about 1,000 people. Schools have held talks given by refugees, to tell of the murderous circumstances from which they have fled. City council officials point out that the 3,500 refugees in other parts of the city face few of the difficulties of Sighthill.

But Sighthill's troubles are not unique: a 22-year-old Iraqi refugee had his throat slashed in an attack in Hull on August 5th. Some view these dismal incidents as the predictable consequence of the government's refugee dispersal policy, especially when it runs alongside restrictive rules that prevent refugees from working until they have been in Britain for six months. When new groups of poor people, who are obliged to survive on hand-outs, are pitched in alongside the already-resident poor, there is bound to be trouble.

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Welsh language

Dim diolch*

Aug 9th 2001 | CARDIFF
From The Economist print edition

There are stirrings at the extremes of Welsh nationalism

REMEMBER the old joke: “Come home to a real fire. Buy a cottage in Wales”? Memories of the 1970s, when militant Welsh nationalists set fire to English people's Welsh country cottages, flickered this week when an eminent Welshman declared that non Welsh-speaking outsiders (ie, the English) were the human equivalent of foot-and-mouth disease.

John Elfed Jones, a former chairman of the Welsh Language Board (WLB), was voicing an endemic fear of Welsh-speakers that their language is threatened with extinction by English. The Welsh Language Society (WLS), for example, thinks that there should be laws to restrict house sales in Welsh-speaking communities and to compel private businesses in Wales to fall into line with public bodies and conduct their business in both Welsh and English.

Such calls are viewed with alarm by Rhodri Morgan, first minister of the Welsh Assembly. He turned up at the Eisteddfod, the Welsh cultural festival, on August 7th, to denounce Mr Jones's remarks as “absurd, insensitive, unhelpful and inflammatory.” He pointed out that a restrictive property law would not only be unenforceable but would also push down prices for Welsh house-sellers.

But Mr Jones is not a lone voice. One of Mr Morgan's colleagues, Alan Pugh, the deputy education minister, recently told the Assembly that Welsh is being threatened by English “linguistic globalisation”. On August 8th, Gwilym ab Ioan, a member of Plaid Cymru's national executive, resigned after saying that Wales was becoming a “dumping-ground for England's oddballs and misfits”. Simon Glyn, a Plaid Cymru councillor, complained last year about English immigrants. This week, he published 500 letters of support (and one death threat) he has received.

Since the Welsh Assembly recently extended the list of public bodies which will have to become bilingual to include such outfits as the Student Loans Company (based in Glasgow), further compulsion might seem likely. But John Walter Jones, the current chief executive of the WLB, a government agency, is against it. “You can legislate life into a language, but you cannot legislate a language into life.”

He points out that, because of the prevalence of Welsh in schools, the number of young Welsh speakers is rising fast. And, because of public sector bilingualism enforced since 1993, the opportunities to use the language are now greater. S4C, a subsidised television company, broadcasts 30 hours a week of Welsh language programmes and BBC Radio Cymru puts out about 120 hours. The outsider may suspect that this is a Taffia plot to boost Welsh-speakers' job prospects, but Mr Jones maintains that no English monoglot is barred from employment.

While many big companies, such as banks and chain stores, have gone bilingual, small businesses view the prospect of being forced down that road with horror. “It would add enormously to costs,” says Russell Lawson of the Federation of Small Businesses Wales. Fortunately, small businesses have allies in unexpected quarters. When the WLS pressed the demand at a meeting of the Assembly's culture committee, it was told by Dafydd Wigley, a former Plaid Cymru leader: “What is reasonable for a privatised utility might not be for a small business in Newport.”

*No thank you

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About sponsorship

The economy

Gloom at the Bank

Aug 9th 2001
From The Economist print edition

The Bank of England is increasingly pessimistic about growth prospects

THE Bank's Monetary Policy Committee surprised financial markets last week when it lowered interest rates by a quarter-point to 5%. This week it revealed the reason for its decision. Even with that cut in rates, the MPC has yanked down its forecast for economic growth over the next two years. As a result, inflation will stay below the government's target of 2.5%.

In its quarterly *Inflation Report*, the Bank forecast that growth will dip close to 1.5% in the year to the third quarter of 2001. Subsequent recovery will be muted. The MPC's central projection is that economic growth will be about half a percentage point lower over the next 12 months than it forecast in the May report. This implies that GDP will increase by only 2% this year, a significant undershoot from the forecast of between 2.25% and 2.75% which Gordon Brown made in his March budget.

There are two main reasons why the Bank has got gloomier. Firstly, the global slowdown has intensified. The MPC highlights in particular the sharp reverse to growth in the euro area. As a result it has cut its forecast for world economic growth this year by half a percentage point. It now says that world trade will grow by 4% rather than the 6% it forecast in May. Last year trade grew by 11%.

Secondly, business investment has recently been lower than expected. “The committee has been surprised on the downside,” said Mervyn King, the Bank's deputy governor, presenting the *Inflation Report*. The MPC now thinks that business investment growth will be weak over the next two years, partly because of growing pressures on company finances. The ratio of debt to profits in the corporate sector is now higher than in the recession of the early 1990s. The Bank says that a fifth of British companies have become financially vulnerable.

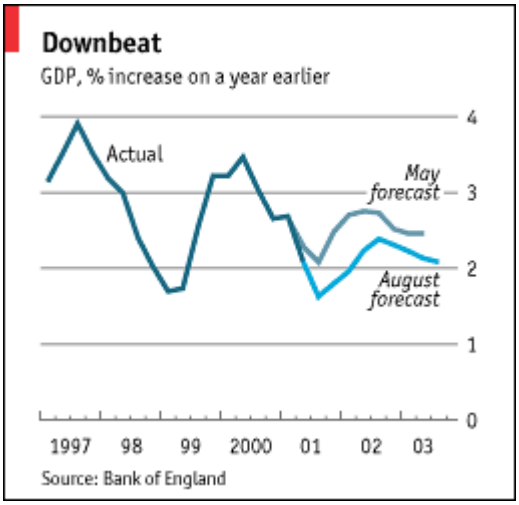
Set against this, the MPC has to take into account Britain's dauntless shoppers and house-buyers. Retail spending has been growing at its fastest rate since 1988. House prices have also been rising merrily at around 10% a year. With inflation so low, households have been borrowing more because interest payments do not swallow up so much of their income.

Easier money may add fuel to this fire. This is why City economists expected the MPC to stay its hand this month. However, the Bank has somewhat reduced its medium-term forecast for consumer spending growth and says that it could turn out to be even lower because household debt has reached a record level in relation to income. Mr King said that the longer it takes for growth in consumer spending to fall to a more realistic rate, “the greater the correction that will ultimately be required”.

The Bank now expects the economy to grow over the next two years by less than its potential rate of 2.5% a year. This will ease capacity pressures and so keep inflation comfortably at bay. The MPC is unfazed by the recent upsurge in the annual inflation rate from 1.9% in March to 2.4% in June. It says that much of this increase has been caused by a big but temporary increase in seasonal food prices resulting from bad weather. By 2003, it expects inflation will be a little lower than it was forecasting in May.

The MPC's decision to cut interest rates ran counter to Mr King's long-declared ambition to make monetary policy as boring as possible. This week he said that he hoped that the MPC would be able “to return to a pattern of extreme boringness in the future”.

However, he also warned that the risks to the Bank's central projection for growth were on the downside. While the world economic outlook remains so unsettled, both he and the Bank, not to mention the British economy, seem condemned to live in interesting times.



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Foot-and-mouth disease

Muck, brass and politics

Aug 9th 2001
From The Economist print edition

Farmers have been paid too much compensation for slaughtered animals, but the fault is mostly the government's

Reuters

THIS government and Britain's farmers have never got on, but relations have sunk to a new low over the bill for the foot-and-mouth outbreak. So far, it comes to about £2.2 billion, or 0.7% of government expenditure. Of that, farmers have got £936m in compensation for the destruction of their animals, and the rest has been spent on the clean-up operation and on hiring extra staff such as slaughtermen. The government thinks this is too much, especially as the bill will rise still further.

In an August holiday week devoid of much news, the press had a field day with stories of the 37 “foot-and-mouth millionaires”, including one farmer who might pick up £4m. There are also mutterings that farmers have got up to all sorts of fast practice to claim more compensation money than they are entitled to.

Farmers are outraged, not just that the government released details of the amounts of money being paid to individuals, but also at the thrust of the complaints. They argue that justice demands that they should be compensated for assets destroyed to stem the spread of a disease which the state's negligence allowed into the country in the first place.

Both the Public Accounts Committee and the National Audit Office are to launch inquiries into the system of compensation, which has now been changed by the government in order to save money. And the European Commission, which may find itself paying up to 60% of the costs of Britain's outbreak, is to carry out its own anti-fraud investigation before it hands any money over.

These investigations will take months; but it is already fairly clear what has happened. Compensation has indeed been over-generous, but the government's attempt to blame the farmers is shoddy. The fault lies with the government for designing a rotten system that set prices too high and encouraged fraud.

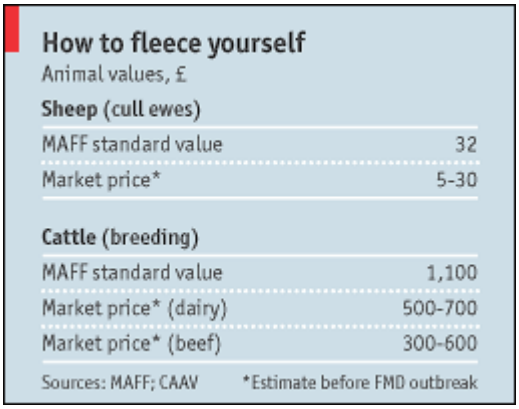
The faulty compensation scheme, now discontinued by the government, was introduced in March, about a month after the outbreak started. Until then, farmers were compensated at a market rate determined by a valuer chosen by the farmer from a government list. But the new scheme introduced another option for farmers, of being compensated at “standard value”. This was a minimum price for livestock, which was already above the prices prevailing in the market before the disease took hold (see table). The new system was designed to be generous, in order to encourage farmers to come forward with diseased animals quickly and speed up the cull.

The main effect of the standard value was to set a floor. Since even the mankiest animal was decreed to be worth at least the standard value, the prices put on most beasts rose far higher. With market prices so high, only 10% of farmers opted for standard value.

An EU investigation, carried out in April, explains how the new scheme was open to abuse. Farmers could select a valuer from the government's list. Valuers were paid 1% of the price that they placed on the farmers' stock. As the EU report laconically remarks, this allowed the “potential risk of conflict of interest”. Valuations were “significantly higher” than the standard values,

and in some cases “excessive payments” have been made. What's more, “discrepancies between animal numbers at the time of the initial FMD confirmation and those presented for valuation, suggest that there may have been illegal movements of animals on to farms during this period.”

The EU recommended “immediate action” to change the valuation procedures in June, but nothing was done until the end of July. But even if the government could not spare the time to study the EU report it might have looked at the official report into the 1967 outbreak. That chronicled how the valuations rose during the outbreak as more animals were slaughtered and valuers “guessed” that the shortage of stock would be reflected in the price of livestock when the markets reopened.



From the EU report, it seems that some farmers have committed fraud, and most have got more from taxpayers for their animals than they would have done from livestock dealers. But the government cannot bleat about the high cost of the crisis. It introduced the flawed system that has made it so costly.

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Semiconductor manufacturers

The great chip glut

Aug 9th 2001 | KUCHING, SARAWAK
From The Economist print edition

East Asia has become addicted to making microchips. The result could be chronic global overcapacity for this basic high-tech commodity

A SWAMP in the jungle of Borneo, in the Malaysian state of Sarawak, provides clues about what ails the global semiconductor industry. Sarawak has done well in the past few decades—timber, gas and oil have made it comparatively rich, and headhunting (of the traditional sort) went out of fashion over a generation ago. In the 1990s, though, Sarawak's government got ambitious and decided it was time to build a modern, high-tech industry. Semiconductors sprang to mind.

A first attempt, in 1996, failed. A second fared better, and this year a $1.7 billion wafer fabrication plant, or “fab”, opened in the swamp. Two more are planned. The fact that 1st Silicon, as the swamp-fab's operator is called, will be supplying microchips at a time when virtually nobody in the world seems to want any is awkward but beside the point, says Claudio Loddo, its chief executive. “Silicon drives development; silicon is the benchmark of the future,” he explains. “Otherwise your people remain dumb.”

Mr Loddo's company is part of a pan-East Asian phenomenon that represents one side of the semiconductor industry's woes: oversupply. The other, better understood, side concerns demand, which has dropped precipitously this year. During the recent tech bubble, western makers of computers, mobile phones and other electronic gadgets speculated by stockpiling microchips. When the bubble burst, they were stuck with those inventories and stopped ordering more. The price of standard memory chips has dropped by 80% over the past year, and global sales are down by half. Fancier logic chips are faring almost as badly, and rumours abound that Intel is about to cut the price of some of its chips by up to 50%. If the chip industry adjusted to demand by cutting supply, its pain would last only until demand recovers. Thanks to East Asia's chip obsession, however, the industry is more likely to keep adding capacity, thus making its own problems worse.

The addiction to microchips has a history. Japan entered the industry first, in the 1970s. South Korea, Taiwan and Singapore followed in the 1980s and 1990s. In South Korea, Samsung and Hyundai, the country's two largest industrial conglomerates, turned their semiconductor units into two of the world's three biggest memory-chip makers (the third is America's Micron Technology). In Taiwan, Taiwan Semiconductor Manufacturing Company (TSMC) and United Microelectronics Corporation (UMC) pioneered the “foundry” concept—contract-manufacturing chips designed by other companies—and dominate this part of the industry today. In Singapore, Chartered Semiconductor Manufacturing imitated the success of the Taiwanese.

Invariably it was governments, rather than markets, that kick-started the move into chip-making. In some countries, such as Taiwan, the involvement was direct and temporary: both TSMC and UMC were spun off from government-funded research projects into publicly listed companies. In other cases, the involvement was indirect and open-ended: in South Korea, for instance, the government leaned—and continues to lean—on commercial banks to finance the move into chip making by the country's family-controlled conglomerates. The benefits for economic development seemed to justify this approach, and Singapore and Malaysia, too, accepted the idea without question.

As yet, the pain is too new to challenge this mindset seriously. The most desperate chip maker, for instance, is South Korea's Hynix Semiconductor, formerly named Hyundai Electronics Industries. It has been making spectacular losses (to the tune of $1 billion in the second quarter alone) but, in time-honoured fashion, received a government-brokered $4 billion rescue package from its creditor banks in May. (Not surprisingly, Hynix's rivals in America are now lobbying the World Trade Organisation to intervene against this subsidy.) Gestures to cut capacity have been largely symbolic. Hynix has suspended only one of its fabs, in Oregon.

The big foundries in Taiwan and Singapore are more open about their difficulties, but no more intent on cutting capacity. UMC reported a loss for the second quarter and says that capacity utilisation crashed from 70% in the first quarter to under 30% now—about the same as at TSMC. Even so, none of them plans to cut capacity seriously. UMC will close some fabs, but only to upgrade them to higher technologies. The Malaysians are adding capacity as fast as they can. Besides the new fab in Borneo, this year they also opened a foundry on the mainland.

All this is nothing beside the capacity that is about to come onstream in China. In Shanghai alone two new fabs are under construction, another two are on the drawing board, and over a dozen more are in the early planning stages. As ever in Asia, the government is not far behind the scenes. The fab project that has caused the greatest excitement, for instance, happens to be chaired by the son of Jiang Zemin, China's president. China is likely to outdo its neighbours in chip making. Its universities produce more engineers than the rest of East Asia combined, and the people they churn out still demand only a fraction of their counterparts' salaries. And China, alone in the region, has a huge domestic market to feed. It is the only country in the world where sales of computers and mobile phones are still booming.

Compulsion disorder

Will East Asians continue in their enthusiasm for chips, regardless of whether the economic conditions are favourable? Scott Foster of the Tokyo office of Lehman Brothers reckons that “all other Asians are gradually turning South Korean. The symptoms are compulsive building of excess capacity and a firm belief that no matter how far prices drop, if they only add even more capacity, things will be OK.” Andy Xie, an economist in Hong Kong with Morgan Stanley, thinks that seeing “men in white coats” in their semiconductor fabs fools Asian politicians and tycoons into thinking that they have caught up with developed economies.

It is ironic, therefore, that the real effect on East Asian economies of continuing to nurture a chip industry may be a return to old ills. Malaysia's economy, for instance, used to bob up and down with the world price of palm oil, tin and other commodities. It now bounces with the world market for microchips. Electronics—most of it semiconductor-related—comprises 60% of the country's exports and 42% of its GDP. Rudie Chan, an analyst at ING Barings in Kuala Lumpur, estimates that a 20% drop in electronics exports slices three percentage points off Malaysia's GDP growth. Meanwhile, Hynix alone accounts for some 4% of South Korea's exports.

As East Asia's economies struggle up the much-touted “value chain”, therefore, they might simply be replacing one vicious commodity cycle with another—and ruining the global economics of an important industry in the process.

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Satellite television

Another twist in the tale

Aug 9th 2001
From The Economist print edition

A counterbid for DirecTV has put Rupert Murdoch's nose out of joint

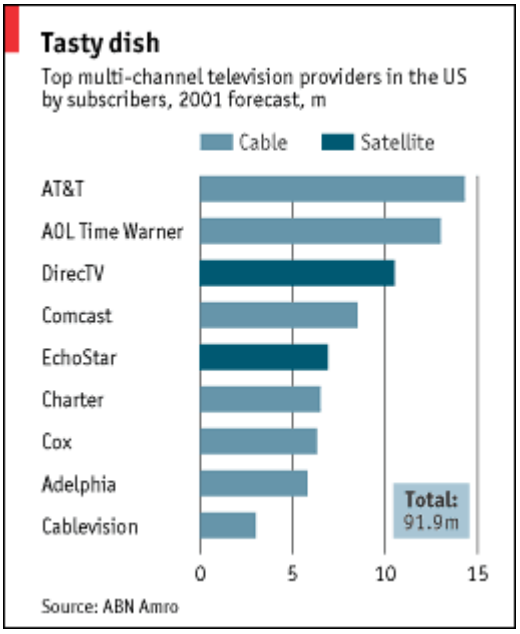
AP

Part of the Murdoch dream

"DIRECTV is the be-all and the end-all for Rupert Murdoch," confessed one News Corporation colleague a few weeks ago. So it was with dismay that the media giant greeted the news on August 5th that EchoStar, a Colorado-based satellite company, had thrust in a rival bid for Hughes Electronics, whose chief asset is DirecTV, America's biggest satellite-television operator. Will this spell the end for Mr Murdoch's ambitions to create the world's first global satellite-television network?

EchoStar's last-minute all-share offer, worth $32.3 billion, came just ahead of a board meeting of General Motors, which owns 30% of Hughes. Members were due to consider the latest details of a longstanding bid by Mr Murdoch for DirecTV. Now, they have a rival pitch to contemplate. Charlie Ergen, EchoStar's boss and a one-time professional blackjack player, whose previous offer for DirecTV was rebuffed by its managers, this time appealed directly to shareholders.

The bid is brazen not only in its timing. With 6m subscribers, EchoStar is little over half the size of the business it wants to swallow, and heavily in debt. Combining the two firms would propel the merged group to the top of the multi-channel pay-TV league (see chart). Mr Ergen, unburdened by self-doubt, claims he could find synergies worth $56 billion. It would also, he argues, establish "the only fully competitive alternative to the powerful US cable/broadband providers."



Mr Ergen, who has built a satellite-TV business from nothing in six years, has little to lose. If he wins over GM's shareholders, he will catapult himself into the media big time. If he fails, because News Corp improves its own offer, he will have forced Mr Murdoch to stretch himself even further financially. Even if he only manages to delay a sale to News Corp, he will at least have distracted Hughes from getting on with the running of DirecTV, which has been losing market share.

For Mr Murdoch, the timing could scarcely be worse. For years, he has dreamed of creating a necklace of satellites around the world. His chain already reaches from Japan (Sky PerfecTV) and Asia (Star) across to Latin America and Europe (BSkyB). The missing link is North America, home to most of his content businesses, such as 20th Century Fox and Fox News Channel. If Mr Murdoch can secure DirecTV, he will have created a truly global operation with nearly 100m subscribers.

In one sense, Mr Murdoch's preoccupation with satellite is odd. Satellite TV's share of multi-channel subscriptions in America may have swollen nearly sixfold since 1995, according to Veronis Suhler, an investment bank. But, with 16% of the market in 2000, it remains a baby next to cable.

Mr Murdoch's desire for DirecTV is motivated in part by the economics of imperial ambition. The enlarged group could find economies of scale, for example, in the manufacture of the set-top boxes needed to decode its signals. But it was the birth this year of AOL Time Warner, America's first truly integrated

media giant, that “focused Murdoch's mind”, as one News Corp executive puts it. By combining programmes with pipes, an operator secures both a “billing relationship” with the watchers of all its stuff, and power over what stuff gets watched.

Owning a distribution channel, whether satellite or cable, guarantees an outlet for your content, making it easier to launch new networks, and fortifies your bargaining power over carriage rights. With a global satellite presence, News Corp would be able to chop up and repackage content for different markets many times over. “If you control lots of channels, 24 hours a day across the globe, the economics change almost exponentially,” says Peter Kreisky, head of the media practice at Mercer Management Consulting.

There is a further piece to this synergistic picture, which goes by the disarmingly anodyne name of the “electronic programme guide”. This, essentially, is the home page you see when you turn on a digital television set. Mr Murdoch part-owns Gemstar-TV Guide, which operates such a guide in 12m homes. In the first quarter of this year, Gemstar's interactive revenue rose sixfold to $14.7m. More important, as BSkyB is demonstrating in Britain, the guide is a powerful gatekeeping device, allowing an operator to divert viewers to certain channels.

Mr Murdoch will do what he can to stop DirecTV slipping through his hands. It helps that, even if GM shareholders plump for EchoStar, the proposal will be tricky for the regulators. This is not just because the combined group would control about 90% of America's satellite-TV market: there are lots of cable operators in pay-television too. But each cable firm has a local monopoly. So, were the only two big satellite firms to merge, this would leave most Americans with a choice of one cable and one satellite operator. If the regulators found this unacceptable, News Corp would end up as the chief suitor for Hughes after all—and in a stronger position than ever.

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Managing Russian companies

A touch of refinement

Aug 9th 2001 | NIZHNEVARTOVSK
From The Economist print edition

Might TNK become the first Russian firm to hire foreign managers en masse?

WHEN an oil company's chief executive has to abandon his headquarters to take direct charge of the firm's main oil field, something is clearly amiss. Simon Kukes, a Russian-born American who is the boss of TNK, one of Russia's largest oil companies, got so cross earlier this year with mismanagement of the Samotlor field, TNK's largest, that he has moved there to run it himself.

Even world-class oilmen would find Samotlor's 15,000 wells tricky. Discovered in the declining years of the Soviet Union, the field was initially so productive that it was jokingly blamed for prolonging the cold war. Now most of the easily extracted oil is gone. The remaining eight billion recoverable barrels are fiddly to reach. Only 6% of what comes up these days is oil; the rest is water, pumped down in the past to keep the pressure up. Raising the oil profitably requires very modern technology and careful planning.

These are not Russian strong points. Technical skills are good, but the rest is mostly dire: sharing information is seen as a sign of weakness; dodging blame is better than raising profits; cost control and conservation are tiresome irrelevancies. Improving management by bringing in outsiders is hard, however. Stories abound of newcomers struggling to have a real say, such as CFOs hired to impress foreign investors but deprived of real data about the company's fortunes.

Tnk itself is a good example. Under a deal last year, it raised money from America's Eximbank to hire Halliburton, an oil-services company, to help manage the Samotlor field. But for the first six months the American experts were frozen out by jealous locals. The Russian managers derided their new-fangled technology (such as drilling horizontally) and resented outside involvement in deciding which wells deserved a share of TNK's investment budget and which should be left alone.

Mr Kukes's presence has solved that problem, and Halliburton is now hard at work. He has had some other successes—decentralising purchasing and logistics, for example—as he tries to break Soviet-era habits. The next big step is to bring in lots of western middle managers. No blue-chip Russian company has done this before. Mr Kukes is trying to hire up to 35, which will be around a fifth of TNK's upstream management.

That, he hopes, will help change the whole culture of the company, to one where managers think for themselves and shed the bad habits of the past. “I need people to take risks, to take decisions, to manage technology,” says Mr Kukes. Fine, but by his own admission, changes happen fastest when a Russian company has outside owners who are prepared to back western-style management. “I am convinced we can't do it on our own,” he says. “We need a foreign partner. It is hard to empower managers in a young company where shareholders take a short-term view.”

Mr Kukes is too cautious to say so, but he could well be speaking about himself. His relations with TNK's owners (a mixed bunch of locals and émigrés with reputations ranging from the respectable to the terrifying) are sometimes strained. He seems curiously removed from big decisions about company strategy, such as a long-awaited pact with BP, announced on August 2nd by the main shareholders, but in Mr Kukes's absence. The harsh weather and ferocious insects of Siberia may seem quite congenial when compared with Moscow's corporate jungle.

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General Motors and fuel cells

Stationary draw

Aug 9th 2001 | DETROIT
From The Economist print edition

A bet on the fuel cell taking off first in homes and offices

IT PROMISES to revolutionise the car industry, but can it also transform the way we power our toasters and televisions? Many enthusiasts expect the fuel cell, a clean and efficient technology, to replace the internal combustion engine over the next two decades. General Motors, the world's biggest car maker, is also betting that fuel cells could become a familiar sight in the home and office as well. On August 7th the company pulled the wraps off a refrigerator-sized prototype which, it hopes, will have shrunk to the size of a TV and yet be capable of producing up to seven kilowatts of electricity by the time it goes into production between 2003 and 2005.

Fuel cells are an essentially simple idea, based on combining hydrogen and oxygen to produce water and electric power. Since they are much cleaner than internal combustion engines, fuel cells are seen by proponents as the ideal alternative. First, though, fuel-cell devices must become smaller, more reliable and—most important—cheaper.

Few people expect high-volume production of cars powered by fuel cells to begin until the end of the decade. The home is another matter. Conditions in a basement are less severe than those facing a car, and size is less of an issue. Recent power shortages in California offer encouragement: many businesses are willing to pay a premium for an uninterruptible supply of energy. GM is only the largest of several companies rushing to supply them with stationary fuel cells. International Fuel Cells, a unit of United Technologies, has announced plans to provide a fuel-cell system for a big commercial and residential development near Los Angeles International Airport.

Why is GM entering the home-and-office market now rather than sticking to its knitting? For two reasons. First, if stationary fuel cells take hold before cells in cars, the company will be able to earn an early return on its hefty investment in the technology. Second, the cost threshold for fuel cells is much more demanding in automotive applications than it is in stationary power: an internal combustion engine is cheap to produce, costing only $50 per kilowatt.

Even so, price remains an obstacle for homeowners too. Most fuel-cell companies project prices of $3,500-5,000 per kilowatt, significantly more than the price of a conventional generator. GM, however, forecasts a price of just $350-500 a kilowatt. Precisely how it will achieve this, it is not saying, though insiders hint at new mass-production methods. Today, each fuel cell must be carefully built by hand. Has GM really found a way to stamp them out as quickly and cheaply as car bumpers?

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Microsoft and Windows XP

Nothing if not tenacious

Aug 9th 2001 | SAN FRANCISCO
From The Economist print edition

Another year, another Windows

Get article background

RULE number one at Microsoft is never give up. It came as no surprise that the software giant appealed to America's Supreme Court on August 7th to overturn the recent appeals-court ruling that the firm had repeatedly abused its monopoly. Nor was the timing of the move unexpected, coming as it did two days before the case was to be handed to a new judge to decide on remedies. What amazed instead was the scope of the appeal. Microsoft essentially asked to have the entire case against it thrown out on the grounds that the original trial judge, Thomas Penfield Jackson, was biased.

It is unlikely that the Supreme Court will take the case. Although the appeals court criticised Judge Jackson for talking to reporters during the trial, it saw no evidence of bias in his findings.

Yet Microsoft's move will not have been in vain. At the very least, it will have gained some time—which is why, cynics say, it filed the appeal in the first place. The delay makes it even more unlikely that any legal action will block the release of Windows XP, the new version of Microsoft's flagship operating system, on October 25th. This is no small matter for Microsoft, for its new software, many agree, repeats its misconduct and violates the standards set out in the appeals-court ruling.

Even before its latest appeal, time was on Microsoft's side. The new judge was to take over three weeks, at most, before the firm planned to ship the first “gold” copies of Windows XP to computer makers. (Microsoft reportedly wants to ship copies of the program as early as next week.) Now, the judge might not get started for months, if the appeals court grants a request Microsoft has filed to stay the order that returns the case to the lower court, pending word from the Supreme Court.

It was always unlikely that the new judge would decide any time soon whether Windows XP is an illegal product that should not be released. For a start, trustbusters are not certain to file an injunction. What is more, Microsoft could argue, with some justification, that blocking Windows XP is hardly what the computer industry needs in its current slump.

Nevertheless, the contortions around Windows XP show that Microsoft will probably never again be completely free in how it designs its software. The most visible conflict so far has been over the opening screen of the program, or “desktop”. In reaction to the appeals-court ruling, Microsoft announced on July 11th that it would give computer makers more liberty to alter this. But the firm has since made it clear that this freedom has limits. PC makers who choose to promote competing online services must give Microsoft's version, MSN, equal billing.

Microsoft argues that the only purpose of the MSN requirement is to promote choice, adding that PC makers were informed about it early on (an assertion that Compaq denies). To Microsoft's critics, however, the stipulation goes against the appeals-court ruling, which said that the company had abused its monopoly when, in 1996, it barred PC makers from removing an icon for its Internet Explorer browser from the desktop.

The MSN requirement alone is unlikely to make Windows XP illegal. But another issue might: how much bundling should Microsoft be allowed? In 1998, the firm tied its browser to Windows. The new version comes packaged with several products, including Windows Media Player and MSN Messenger.

The risk for Microsoft is less that this generous bundling could itself be declared illegal—although you could question whether these add-ons meet the appeals court's requirement that the benefits to

consumers outweigh the costs of reduced choice. The issue is more one of how the bundling is done. The court found some of Microsoft's “co-mingling” of code from Windows and Internet Explorer anticompetitive, because it deterred PC makers from installing rival browsers.

If Microsoft has done the same with Windows XP, it might be in trouble. It could be forced to design its operating system to allow PC makers to replace its add-ons with competing programs, instead of piling more icons on the desktop. Not least because of this possibility, on July 18th Microsoft filed for a rehearing, saying that the court's decision on this issue was “clearly erroneous”. Its request was rejected.

The political pressure on Microsoft is also mounting. The Senate plans to hold hearings on Windows XP. Columnists are increasingly nervous that Microsoft is headed for world domination. One newspaper, the *San Jose Mercury News*, has even started a “Freedom from Microsoft” campaign, which advocates ways to live without the firm's software.

Perhaps it is time for Microsoft itself to take the decision to postpone the launch of Windows XP until all these issues are sorted out. The firm could thus demonstrate to the world that it is not always bent on pushing things to the limit—and rebuild the trust it has lost. Alas, given Microsoft's DNA, such a move looks likely to remain wishful thinking. More's the pity. Tenacity might be a must in the software world, but in politics it is often a recipe for disaster.

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Tesco

Leahy's lead

Aug 9th 2001 | CHESHUNT AND LEYTONSTONE
From The Economist print edition

A mixture of understatement and quiet confidence has turned Tesco from a domestic grocery chain into a world-class retailer

ARRIVING at Tesco's headquarters is a distinctly underwhelming experience. The company is run from an ugly concrete building in rural Hertfordshire, next door to a handful of scruffy pubs and a betting shop. Inside, dimly lit and spartan, it would make a fitting home for a parochial British manufacturer. Yet with Tesco, appearances are deceiving. It is Britain's biggest and most profitable food retailer. And with 907 stores in ten countries, Tesco ranks alongside Wal-Mart as the third most international of the world's retailing giants, behind Ahold and, at number one, Carrefour.

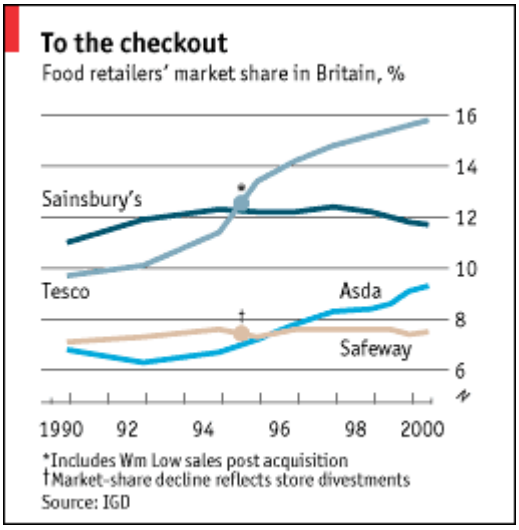
The clocks on the lobby wall give a hint. They show the local time in Hertfordshire—and in Seoul, Bangkok, Hong Kong and Warsaw. All are territories into which Tesco has expanded in the past four years. The firm is at the forefront of technology in its industry. Not only are its supply-chain systems considered to be the best in the world, Tesco is also the world's biggest online grocer, and one of the few that makes money. It recently exported its web-shopping model to Safeway in California, the heartland of technological innovation.

Tesco's lack of grandeur is a clue to its success. Though every company claims to listen to its customers, genuinely doing so requires a humility that is rare in senior management. Terry Leahy, Tesco's chief executive, who personally collects visitors from the group's dingy lobby, has got it in spades. Raised on a Liverpool housing estate, Mr Leahy first stacked shelves in a Tesco store for a summer job. He joined the chain full-time in 1979, made it on to the board in 1992 and got the top job four years ago. “I've been fortunate enough to see all layers of British life,” he says. “I feel I know personally all our customer groups.”

Mr Leahy does not change as much as a light bulb without poring over customer surveys and sales data first. Once he has listened, however, he is not afraid to act, even in the face of conventional wisdom.

When Tesco introduced “Value” lines, a cut-price range of own-label goods, in 1993, competitors scoffed and the share price sank. But Tesco had gauged the popular mood: after years of recession, shoppers were looking for bargains, and sales soared. A year later, Tesco started “One in Front”—opening a new till whenever a checkout line exceeded two trolleys. It cost millions in extra staff, but customers loved it. In 1995, Tesco caused a flutter by introducing loyalty cards, promising discounts to regular customers. These, rivals complained, threatened to destroy the industry's already thin margins. Today, Tesco has 10m Clubcard member households.

Schemes like this have helped to turn round a group that was in trouble in the late 1970s. Started as a single store in 1929 by Jack Cohen, who used to run a London market stall, the chain had hit rock bottom by the time Mr Leahy joined. “The joke was that Tesco was offered to a tobacco company,” he says, “but they thought it would be bad for their image.” Much of the credit for Tesco's revival must go to Ian (now Lord) McLaurin, who moved the group upmarket by imitating J. Sainsbury, then Britain's leading supermarket. (John Gardiner, Tesco's current non-executive chairman, is on the board of The Economist Group.) But it was Mr Leahy's marketing skills and penchant for innovation that helped Tesco overtake its rival (see chart).



Circling the rivals

Though it is possible that Tesco could stumble in its turn, it is currently extending its lead, using size as a weapon. While British rivals such as Sainsbury's and Safeway try to improve profitability, Tesco is deliberately keeping its margins flat, ploughing back into lower prices the gains it reaps from economies of scale. That brings more sales, and so more scale economies. This virtuous circle is similar to the one followed with such deadly efficiency by Wal-Mart in America.

While Mr Leahy promises to keep the main food business strong and innovative, he is steadily diversifying into other areas. The first of these is non-food merchandise, including TVs, computers and clothes. Just like Asda, a rival now owned by Wal-Mart, Tesco has discovered that limiting itself to a few bestselling items in each category, and using its vast buying power to offer them cheaply, can help it outgun smaller, specialist shops: at its Leytonstone store in east London, Tesco recently sold 60 big-screen television sets for less than £180 ($260) apiece in one weekend.

Similarly, the group has moved aggressively into over-the-counter medicines and toiletries. This year, its sales overtook those of Boots, Britain's leading chemists chain. It got another boost this week with the purchase of a majority stake in The Nutri Centre, a retailer of alternative remedies. Overall, non-food, including petrol, now accounts for 20% of Tesco's sales.

The second area of expansion is in services. Alongside its online grocery business, Tesco has a profitable line in financial services, offering accounts and credit cards designed by Royal Bank of Scotland—but sold under the Tesco brand. Mr Leahy reckons that Tesco's low customer-acquisition costs and the trust it has developed with millions of shoppers give it advantages over a traditional bank-branch network. The next project will see customers paying their utility bills in stores—an idea that has worked well for Japan's Seven-Eleven convenience-store chain.

The last plank is international expansion. Tesco is certainly deploying its formidable domestic cash flow to fuel growth abroad: some 40% of its capital expenditure, and of its total floor space, is now spread across nine countries in continental Europe and Asia. For the moment, these still contribute only 13% of revenues and 6% of operating profit, although Tesco's sales jumped by 29% in Europe excluding Britain last year, and by 85% in Asia.

For now, Tesco's overseas expansion remains typically low-key. It has eschewed the splashy acquisitions of rivals such as Wal-Mart, Carrefour and Ahold. Mr Leahy puts this down to two factors. The first is Tesco's preference for working with local partners, such as Samsung in South Korea, whose expertise gives it an edge. (Tesco's sales per square foot in South Korea are twice those of Carrefour.) The second is Mr Leahy's own belief that cross-border consolidation in food retailing still yields few synergies—though he admits they are increasing as tastes globalise.

Tesco's caution makes sense. Wal-Mart is in trouble in Germany, for instance, and Boots has just pulled out of Japan. But Tesco needs to strike a balance. On the one hand, planning restrictions are making greenfield expansion harder in Britain. On the other, Tesco will have to keep a close eye on its home base. Above all, it must make sure that its ambitions outside food do not distract from its main offering at home. Members of the global retailing elite can never relax.

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Face value

Just-in-time people

Aug 9th 2001
From The Economist print edition

Adecco's John Bowmer manages the biggest, most flexible workforce in the world

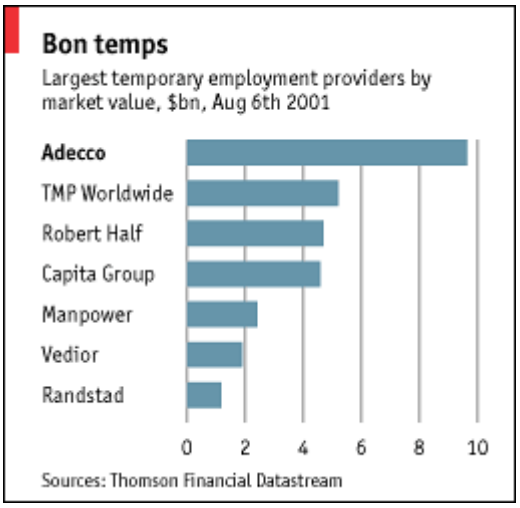
THE epitome of a temp is someone who every Monday morning has to ask the way to the loo. John Bowmer, the chubby British boss of Adecco, the world's biggest provider of temporary workers—some 700,000 of them on any one day—understands that. He works a bit like a temp himself. He lives in Redwood, California, where his wife can be close to their grandchildren. But he is almost constantly on the move. The multinational services company that he runs has its headquarters split between Lausanne and New York. From there it provides centralised facilities for the group's 5,000 offices in 58 countries.

Mr Bowmer rarely spends two successive Mondays in the same place. Regular two-week trips to Europe involve stops in France, Adecco's biggest market; Switzerland, where the company is registered; and Britain, its third-biggest market (the second-biggest is the United States). While in Britain, he sees his elderly parents, who live in Derbyshire, the county where he was born.

There are occasional visits to Grand Prix races to watch the Prost Acer Formula One team which Adecco sponsors. Then there are rapidly growing markets in Asia to keep an eye on. In Japan, for example, business is growing at 40% a year, fuelled by structural changes taking place as Japanese industry weans itself off its obsession with jobs for life. Companies there that need to be competitive are increasingly taking on temporary workers. Sony, for example, got a taste for temps from its experience in the United States. At a plant in California the only way to get a permanent job with the Japanese electronics company is first to have served for ten months as an Adecco temp.

Although the business is known primarily as a provider of temporary workers, some 40% of Adecco's temps move on to permanent jobs with the same employer. At Apple's plant in Austin, Texas, more than half the full-time employees were formerly on Adecco's books.

Mr Bowmer's first job with the group was running its British financial-services division, Jonathan Wren, a job he started just over a month before the stockmarket crash of October 1987. One of his first actions, he recalls, was laying off large numbers of the company's permanent employees, a painful experience and, until recently, one that few of today's managers had experienced, or could remember: the current slowdown is being managed by chief executives many of whom have never worked through difficult times.



Then he was sent to Australia to run the Asia-Pacific region. When in 1992 the board saw that his operation was, as he puts it, sending home particularly handsome cheques, it picked him to run the whole outfit.

In 1996, Adia, the Swiss company that Mr Bowmer headed, merged with Ecco, a French rival. Mr Bowmer (of a conveniently neutral nationality) was chosen as head of the new merged entity, imaginatively named Adecco. The group's growth since the merger has been spectacular. Its target has been to grow organically every year 50% faster than its market, and it has achieved this so far. In an industry that has often seen annual growth of 10% in recent years, that has required growth of a heady 15% a year. Revenues have risen

from SFr6.4 billion ($5.2 billion) in 1996 to SFr26.6 billion last year, profits from SFr202m to SFr746m over the same period.

For some years now, Mr Bowmer has pursued a Jack Welch-style strategy of being number one or two in his markets, or not being in them at all. Adecco is first or second in 11 large markets, including Britain, France, Germany and the United States. Mr Bowmer rattles off the positions from memory, evidence of a prodigious command of his organisation's statistics.

Economies of scale are important to the business. So Adecco is highly centralised in those things where scale is important, and highly decentralised in others. There are particularly good economies to be gained from IT, and the company has reaped these first in the back office. Computerised payrolls have replaced paper-based systems everywhere.

The next step is to move into the front office, to communicate electronically with customers. Italy is currently a guinea-pig for Adecco's Internet-based recruitment service. “I'm very excited about the Internet,” says Mr Bowmer, despite the failure of so many dotcoms. The business model for his industry, he says, has to be clicks and bricks, not clicks or bricks. But it's easier for bricks to add clicks than it is for clicks to add bricks.

Tough times

This year, Adecco's business has been slowing down as its clients pare their workforces in the downturn. Despite managing a 21% rise in operating profit in the first half of 2001, Mr Bowmer says that the drop in the market for Adecco's services has been sharper than in 1990. The market in Europe is now growing at only half the pace it was at the beginning of the year; in America, a similar slowdown occurred at the end of last year.

The company has some counter-cyclical businesses to help it in the short term, such as outplacement (helping laid-off workers to find new jobs). But it is betting its longer-term future on providing just-in-time human resources to large corporations—people and teams as and when the work demands them.

This has been encouraged by the changing nature of Adecco's customer base. Ten years ago, 10% of its business was with big corporations; today, 45% is. These clients don't call up on Friday demanding an office angel for Monday, never to be heard of again. They have a continuous relationship with their temp agency. In some cases Adecco has a permanent office on its client's premises. To these large corporations, “we're not selling people,” says Mr Bowmer, “we're selling productivity.”

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American productivity

A spanner in the productivity miracle

Aug 9th 2001
From The Economist print edition

Statistical revisions show how America's recent productivity boom is less remarkable than was once thought

Hulton Getty

DOTCOM firms have collapsed, and all those business-cycle obituaries now look premature, but so what? The most important part of America's "new economy", namely its productivity miracle, remains intact. That was the view of most commentators this week following the release of new productivity numbers. The assessment is too rosy, as the revised figures themselves confirm on closer inspection. America's productivity growth is higher now than it was before 1995—but the gains have been exaggerated.

Productivity rose more than expected in the second quarter of this year, the new figures show, but part of America's previous surge has now been revised away. According to the old figures, annual productivity growth averaged 3.4% in 1999-2000. That has now been shaved to 2.6%.

Most commentators found relief in the fact that average annual productivity growth in the five years to 2000 had been revised down only modestly, to 2.5%, well above the rate of 1.5% in the first half of the 1990s. On the other hand, Alan Greenspan, the chairman of the Federal Reserve, had placed huge weight on the fact that productivity growth had been accelerating—to 4.3% last year by the old figures. On this basis, he believed that structural productivity growth, after stripping out the cyclical impact of the economic boom, was around 3%. Most of the acceleration in productivity has now vanished, with the new figure for 2000 chopped to 3% (see chart).

What is more, recent productivity gains have been exaggerated not just by the cyclical impact of the boom, but also by an unsustainable surge in investment in information technology that has now gone into reverse. Over-exuberant expectations about profits, allied with an artificially cheap cost of capital thanks to a stockmarket bubble, encouraged firms to over-invest. Investment in information technology has plunged this year, and slower investment growth in future will mean slower productivity growth.

A study published in May by Goldman Sachs estimated that structural productivity growth was 2.25%. Since then, the data revisions and a steeper than expected slump in investment suggest that 2% might be closer to the mark. Add in a 1% annual growth in the labour force. America's potential growth rate then comes to around 3%, rather than the 4% that most American economists had been counting on.

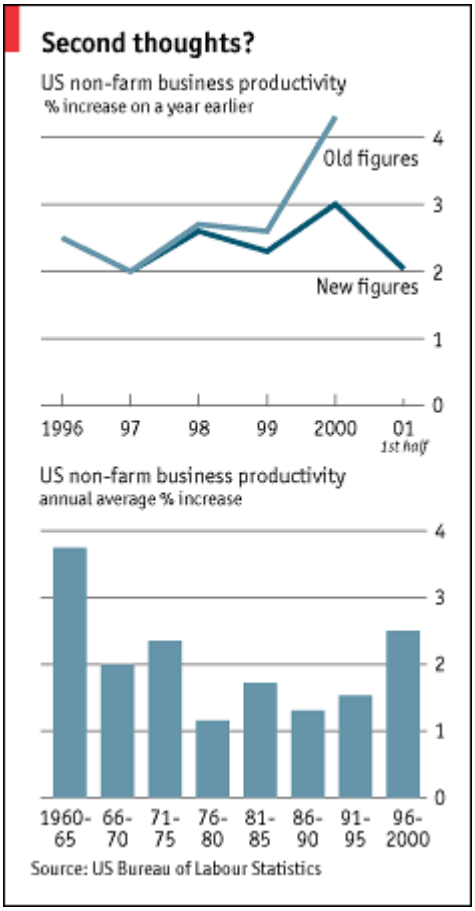
Productivity growth of 2% would still be pretty impressive by historical standards. Those who thought that growth of 3-4% was sustainable were, in effect, making the bold claim that IT would have a far bigger economic impact on America's economy than any earlier technological revolution. The Fed is fond of a chart that shows how productivity grew by an average of 3.8% during 1917-27, thanks to the widespread adoption of electrical power. Sustained productivity growth today of 3%, then, does not seem outlandish. However, the period 1917-27 is misleading, for productivity was unusually

depressed in 1917. Over the period of 1919-29, productivity growth in the non-farm business sector was a more modest 2.3%.

Government statisticians have taken their axe not only to productivity. They have also made huge revisions to corporate profits as measured in the national accounts. Stockmarket bulls drew comfort from the reported surge in American profits during the late 1990s. It was argued that this growth would increase the slice of GDP going to the providers of capital, validating at least some of the rise to unprecedented levels of the price-earnings (p/e) ratio of American shares.

The revised data tell a different story. For the first quarter of this year, the level of after-tax profits of non-financial companies is now more than 20% lower than originally reported. The new figures show that total profits as a share of national income has dropped sharply, from over 12% in 1997 to just 8% last year. An analysis by Ed McKelvey at Goldman Sachs identifies two main causes for the revisions. First, government number-crunchers have discovered more firms making losses than were previously estimated. Second, more employees have exercised stock options than had been expected.

Clearly, companies earned a lower return on the investments they made. This may lead them to be less optimistic about the likely returns available from future investment, which bodes ill for a swift end to the slump in capital spending. Thinner profit margins, in turn, also suggest that firms may be under greater pressure to cut costs, which could extend America's downturn.



Not least, the revisions to productivity and profits raise questions about the level of share prices. Assuming profits as reported in the GDP data move in line with profits reported publicly by companies, profits are likely to fall even further relative to GDP this year. Economists at CSFB estimate that total profits dropped by over 10% in the year to June 2001—and, judging by the continuing stream of disappointing announcements from companies, the profits plunge is not near its end.

What does this imply for share prices? That depends on the extent to which the stockmarket is a rational place, or at least is becoming more so. The fall in profits means that p/e ratios remain high by historical standards, even though big-company share prices have, on average, been flat at best for the past three years, and the share prices of many technology companies have plunged in the past year.

In the long run, profits seem destined to grow in line with GDP— just as they have, on average, for decades. Yet the current level of share prices seems to imply real long-term growth in profits far in excess of likely real GDP growth of, say, 3%. If so, the stockmarket remains a hazardous place for the rational investor.

On the other hand, the rational investor might have avoided the stockmarket for much of the unprecedented bull run of the 1990s. Indeed, periods of gloom about profits have often proven to be the “point of maximum pessimism”, at which investing generates the highest returns—precisely because of the considerable contrarian courage required. The Leuthold Group, a research firm, calculates that share prices have risen in each of the nine worst years for profits over the past half-century. On average, share-price gains in those years have far outperformed the long-run average for the stockmarket. Will history repeat itself this year? Not so far.

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Job cuts at the NYSE

Last orders

Aug 9th 2001 | NEW YORK
From The Economist print edition

The end for a rare breed of stock-exchange official

FOR the first time since the early 1990s, the New York Stock Exchange (NYSE) is laying people off. Indeed, a whole class of professional, that of stock exchange "reporter", is to go, putting 150 employees—one-tenth of the total—out of a job that dates back to the exchange's earliest years.

A sign of the times, but not these times. Reporters once had the job of writing down, with stubby pencil, the price of deals carried out at the trading post. These days, the only time an order is written down on the floor of the NYSE, it is for lunch. Being a reporter must have seemed like having tenure. The reporter with least seniority joined the exchange 17 years ago. His skills were probably redundant even then.

Automation began in the early 1960s, with the introduction of IBM's punch-card machines. In September, the NYSE will launch its "open-order book", an electronic system that will allow outsiders to see not only the price at which a share most recently traded, but also all pending bids and offers, updated every ten seconds or quicker. No human could keep up with that.

Efforts to cut the number of reporters began in 1990, when there were still 300 of them. In recent years, they had "nothing to do", Richard Grasso, the exchange's chairman, admits. Mr Grasso says that "every lost job is a tragedy"—especially if it involves no work, he might have added. Certainly, it would be hard to find a similar position to a reporter's, with its good salary, holiday and pension arrangements, and even a degree of union protection (the negotiated redundancy was generous).

Some of this group may yet stick around. The negotiated terms include the option of "bumping down" to an equally curious position, that of a "senior floor trainee"—a messenger, in short. The salary is not quite as high as that of a reporter. But on the bright side, there are currently no full-time holders of the position, which suggests a workload to rival a reporter's. For the right kind of person, America's financial markets still, it seems, offer remarkable opportunities.

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American policy towards Argentina

Mixed signals

Aug 9th 2001
From The Economist print edition

Poor Argentina deserves better than confused messages from Washington

IMAGINE the agony of a drowning man who watches a group of lifeguards repeatedly pick up and drop a life-belt. That is Argentina's predicament as America sends mixed messages about whether, and how, it intends to help.

Since it came together, George Bush's team has had a confused approach towards emerging-market crises. In principle, the administration is sceptical of bailing out economies in trouble. Paul O'Neill, the Treasury secretary, often pooh-poohs the Clinton administration's policy of actively managing financial crises. He describes his predecessors as playing “chief fireman”; Mr O'Neill wants to eliminate the need for the fire department. In practice, on the other hand, the Bush team is less rigid. After all, it did not decry a $40 billion rescue programme for Argentina organised by the International Monetary Fund last December, and it strongly backed an IMF bail-out of Turkey this spring.

With Argentina's deepening crisis, though, the Bush team has been sending conflicting signals. Barely a month ago, Condoleezza Rice, Mr Bush's national security adviser, made it clear that America had no interest in a new support package. Argentina, she said, needed to take steps by itself to stabilise its economy. Mr O'Neill has been scathing in public about the country, whilst downplaying the risks it poses to the international system. Argentina, he said, has been in trouble, on and off, for 70 years. And while praising the government's current efforts to tighten fiscal policy, he has voiced deep scepticism about the wisdom of fixed exchange rates. Taken together, the message seemed clear: no more bail-outs, and certainly no money from America.

Last week, the message appeared to shift. President Bush, by phone, offered Argentina's president, Fernando de la Rua, verbal support at least for Argentina's efforts to fight the crisis. Tony Blair, Britain's prime minister, hopped over the border during a trip to Brazil, in another show of support. And John Taylor, the Treasury's point man on international policy, flew to Buenos Aires. After a two-day visit, he pronounced himself “impressed” with the government's efforts to pull out of crisis. Though Mr Taylor was careful to say nothing about more money, the arrival in Buenos Aires of such a senior Treasury official was interpreted as a sign that help was on the way. He was, people said, hardly there just to taste the wine.

Then came another lurch in perceptions. At the time of Mr Taylor's visit, the IMF suddenly announced a new $15 billion package for Brazil. Horst Köhler, the IMF's head, was effusive about Brazil's “strong track record” and praised its efforts to deal with “a difficult external environment”—for which, read Argentina. On the same day, he declared that Argentina would get merely an accelerated disbursement, of $1.2 billion, from its existing support package, though he praised Argentina for its efforts at fiscal austerity. Wall Street took these two announcements to mean one thing: that the IMF had largely given up on Argentina and was now trying its best to protect Brazil from contagion. The conclusion was strengthened after a phone call among Messrs Bush and Blair and Jose-Maria Aznar, prime minister of Spain. The leaders again expressed their support for Argentina, but agreed that the “focus” should remain on implementing the existing IMF plan.

Only days later, however, the mood changed yet again. Reports in Buenos Aires suggested that talks about new money from the IMF were quite advanced. Sums of between $6 billion and $10 billion were being bandied about. Washington remains silent—no denial of these reports, in other words. Privately, officials admit that the option of more assistance is being discussed. As *The Economist* went to press, speculation was rife that Argentina was about to be thrown a life-belt, in the form of new IMF money. Either way, America owes it to Argentina to explain what it is doing, and why.

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Insurance in Asia

Unprofitable policies

Aug 9th 2001 | HONG KONG
From The Economist print edition

A fast-growing market, but maybe not one worth fighting over

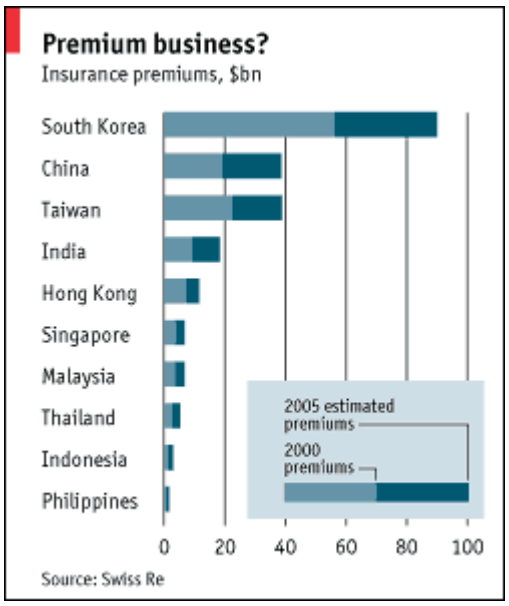
THE only thing now delaying China's accession to the World Trade Organisation (WTO) is a spat between its two biggest members, America and the European Union, over insurance. At issue is whether America's largest insurance company, AIG, should continue to enjoy preferential treatment by China's regulators, thus putting European competitors at a disadvantage. To judge by the effort the multinational insurance giants are putting into urging their respective governments to fight their corner, it would seem that there is a great deal to play for.

Then again, the companies could be wrong. Emerging Asia has long posed a conundrum for western insurers with global ambitions. On the one hand, the region is home to some of the world's fastest-growing markets, at a time when insurance in developed markets is pretty saturated. On the other hand, there is no guarantee that growth brings profits.

In the long term, and if growth were the only criterion, multinationals' regional strategy ought to be clear enough. In a forthcoming report, Kai-Uwe Schanz, chief Asian economist at Swiss Re, the world's second-largest reinsurer, estimates that the insurance markets in both China and India could double in size by 2005. In contrast, most Asian markets, which shrank during the financial crisis of 1997-98, are still making up lost ground.

Moreover, South-East Asia's markets are fragmented—and already open to foreign insurers. India's and China's are highly concentrated, and only just starting to open up. In Malaysia, the Philippines and Singapore, foreign insurers already control over half of the life-insurance market. They have less than 1% in China and not even that in India.

Growth rates can deceive. Take China, which is reckoned to be Asia's most promising market, with 1.3 billion people. Even if insurance did double by 2005, China's market would merely rank alongside Switzerland's in size. If it doubled again by 2010, it would be equal to Italy's. More important, in any case, is the fact that growth alone says nothing about whether foreign insurers would make money from these markets.



The lure of losing

In China so far, they have not. The multinationals give few hard figures about their Chinese business, but, by best estimates, only AIG, the first foreigner in China, was briefly profitable and now barely breaks even; all other multinationals lose money. With or without the WTO, this is unlikely to change soon, says Stephen Harner, a consultant in Shanghai. In the current jostling for licences, “the winners may end up

envying the losers.”

In China, insurance is unprofitable partly because the only people who can afford to buy policies are the top earners, and the only way to reach these (in a country that had no insurance at all until the 1980s) is by sending agents from door to door. There is no more expensive way of selling insurance. In developed markets, insurers make their profits entirely from investment income, since premiums are usually too small to cover claims and expenses. In China, on the other hand, insurance companies are condemned to invest mainly in low-yielding bank deposits and government bonds. China now plans to allow insurers to invest directly in the capital markets. Yet the stockmarket is, says Wu Jinglian, China's grand old man of economics, “worse than a casino”.

It is unprofitable especially because of red tape. Ma Yongwei, China's insurance regulator, likes to talk about the “golden opportunities ahead” for foreign insurers. In practice, however, regulators will work hard to take the shine off. Much as in Japan two decades ago, says Mr Harner, the regulators' priorities are not to benefit consumers, but to nurture a strong domestic industry. The regulators will tolerate foreigners, and even make a point of learning their skills. But they will not want to let them prosper, and that is something which will not change much with WTO membership.

A few hurdles

Consider the straitjackets for foreign insurers in China. To enter the market at all, multinationals must maintain representative offices for years before upgrading these to branches. In between, there is a lot of entertaining of regulators in karaoke bars. Then, insurers may do business in just one city at a time—and, in non-life insurance, with foreign customers only. In life insurance, China forces foreigners (with the exception of AIG, hence the spat) to form joint ventures with local companies. Foreign insurers which want access to the national market (as opposed to one city) may take stakes of up to 25% in a domestic insurer—provided, that is, they get the regulators' say-so.

The idea in all this is to attract foreign expertise and to pass it on to locals before the foreigners can capitalise on it. Given this, corporate strategists at western headquarters may do well to weigh up as much whether to invest in Asia as where and how much.

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Export-credit insurance

Insuring Africa

Aug 9th 2001
From The Economist print edition

Introducing a new regional agency to insure against political risk in Africa

LIFE may soon get easier not just for Vimal Shah, managing director of Bidco Oil Refineries, a Kenyan company which exports cooking oil and margarine all over the region, but also for his customers. Wary of the commercial and political risks, his company sells only to customers that pay cash, or that get a letter of credit from an international bank. The cost of a letter of credit can be steep: up to 5% of the amount of a sale, compared with as little as 0.1% in Europe. And this assumes that a letter of credit can be obtained at all. Public and private insurers of export credits have a scant appetite for sub-Saharan Africa. Trade finance is scarce. All this, says Mr Shah, is bad for business.

The African Trade Insurance Agency, which starts this month, may be what he needs. Headquartered in Kenya, the regional body will provide insurance for exports to, from and within Africa. For now, the agency will offer insurance against political upheaval, expropriation and problems with exchange controls on trade involving Kenya, Malawi, Tanzania, Zambia, Uganda, Rwanda and Burundi. Other African countries are expected to join the scheme before long.

If financiers are wary of unstable or capricious governments in the region, why should they trust yet another regional body? It may help that member countries will be held financially responsible for any losses they generate. And the $105m of loans from the World Bank—made to participating countries but held in escrow in London—that constitute the scheme's financial backbone should help as well. If claims arise, compensation will be paid out of these escrow accounts, which the participating governments will then have to replenish.

The scheme's credibility also rests on its private participants. According to Ivan Rossignol, the World Bank's project manager in Nairobi, the point is to use public money to encourage private insurers to venture further into Africa. The World Bank loans will be used to pay for first losses, but underwriters at Lloyd's of London will insure an additional $200m-worth of exposure. As the scheme expands, the private-sector share is expected to increase. In addition, the agency is meant to be commercially viable. Over the next ten years, the scheme is expected to foster an additional $5 billion in trade for the seven participating countries.

Buying protection against political and exchange-control risk, however, does not take care of the risk of non-payment by the importer. This is why the agency is now exploring whether private providers of credit insurance might be prepared to reinsure commercial-risk cover, were the agency to offer it.

Mr Rossignol says negotiations are on the right track: the agency aims to provide full credit-risk insurance before the end of the year. Still, how the private sector would bear the commercial risk remains unclear. The credit rating of commercial companies in Africa is virtually unknown. In addition, most African countries lack proper bankruptcy laws, which makes recovering losses difficult. This could be enough to discourage the most adventurous of credit insurers.

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Financial scandals in India

Slaves of the state

Aug 9th 2001 | MUMBAI
From The Economist print edition

One more bail-out hits India's credit rating

ANOTHER week, another government bail-out. This time it's the flagship Industrial Finance Corporation of India (IFCI), which had ducked some principal payments on its bonds. IFCI was founded in 1948 and is the third-biggest long-term lender in India. It was made a joint-stock company in 1993, but is still majority government-owned through the Industrial Development Bank of India and other institutions. IFCI has borne the cost of India's history of inefficient industrial development, frequently as a pawn in the game of graft and political patronage. The price today is a bailout costing some 10 billion rupees ($210m), three-fifths to be met by core shareholders, two-fifths in the form of 20-year convertible bonds financed by the government.

This follows a partial bail-out in July of 20m investors in India's biggest equity savings scheme: US-64, a fund managed by the Unit Trust of India (UTI). The prime minister, Atal Behari Vajpayee, threatened to resign last week, in part because of the UTI affair, but was persuaded to stay.

Another indignity came on August 7th when India's shaky finances prompted Standard and Poor's, a rating agency, to announce a downgrading of the country's local-currency rating, from BBB to BBB-minus. The reason was India's “unchecked” budget deficit and rising domestic indebtedness—close, respectively, to 10% and 70% of GDP. On August 8th Moody's, another agency, downgraded both India's foreign- and local-currency ratings.

A decade of economic reforms has failed to loosen the government's grasp over the country's biggest banks, insurance companies and mutual funds. They control four-fifths of bank assets, two-thirds of mutual-fund assets and the entire insurance industry. In the days of a centralised economy, these institutions were key agents of state control and capital allocation. They used their near-sovereign ratings (because of an implicit government guarantee on their borrowings) to mop up cheap money and to allocate it as the state wished, often funding budget deficits. After liberalisation in the 1990s, when managing risk became more arduous, and prudential rules were introduced, their health began to fail. Their non-performing loans total over 790 billion rupees, or around 4% of GDP, and their credit ratings are lower than those of top corporate borrowers.

Following the bail-outs, the government has tightened its control over IFCI and UTI, a setback for liberalisation. The new head of UTI is a bureaucrat, while the post of government nominee to the board—abolished a few years ago—has been revived. The injection of convertible bonds to bolster IFCI's capital will make the government a direct stakeholder. Politicians will continue to meddle in the running of these institutions, which is the main reason for their problems in the first place.

The government's handling of UTI, with investigations by three separate groups—a team of parliamentarians, the police and a panel of experts—looks more like an attempt to whitewash politicians rather than to nail the problem. The UTI's former chief, Pavagada Subramanyam, who faces criminal charges over a private deal to buy shares—now worthless—in a software company, will probably be made a scapegoat.

Industrial Development Bank of India, the country's biggest development bank and a cash-strapped one to boot, came reluctantly to the rescue of both IFCI and UTI. Now it could be next in line for a government bail-out itself, a former finance minister, Manmohan Singh, warns. Crisil, a rating agency, downgraded the development bank last month, concerned by the poor quality of its assets. Meanwhile, the government is still looking for someone to head the bank, six months after the previous chief retired.

These state institutions hold most of India's household savings, and savers continue to pour money into

them in the belief that they enjoy ample government protection. Weaning people from that belief—which distorts economic decisions—will not be easy. Meanwhile, the market has given its verdict. The shares of Industrial Development Bank of India, for one, trade at one-seventh of their issue price six years ago.

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European economies

Out of puff

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The euro area's economies are wilting fast. When will they revive?

MONTH after month, the evidence has been piling up: flagging business and consumer confidence; weakening industrial production; rising unemployment. Europe may not be wheezing quite as badly as America, still less Japan, but it is far from fighting fit. This week, there were more weak data: Italian GDP was flat in the second quarter; and joblessness in Germany rose in July, for the seventh month running, albeit by less than expected. At the end of last year, the economic forecasters polled monthly by *The Economist* were predicting that euro-area GDP would grow by 2.9% in 2001. Now they reckon on only 1.9% (see chart).

Germany, the euro area's biggest economy, is in worst shape. Nothing new in that: its annual GDP growth has averaged just 1.5% since 1992. A number of economists suspect that the economy may have shrunk in the second quarter; some think it may do so in the third as well, which would satisfy the most widely used definition of recession. Granted, the increase in unemployment has in fact been slight: the rate has risen by a mere one-tenth of a percentage point this year, to 9.3%. Nonetheless, no one expects joblessness to start falling again soon.

Even France, hitherto the brightest of the continent's large economies, has lost its shine. Lately, unemployment has risen more sharply there than in Germany. This year the number of temp-agency workers has fallen by 11%, to 650,000—showing, says Stéphane Déo of UBS Warburg, the speed (and ease) with which some French companies are shedding workers. Italy, too, has run out of steam. In the fourth quarter of last year, thanks to surprisingly good net exports, its GDP grew by 0.8%. Ditto in the first three months of 2001, thanks to a build-up of inventories. Once these one-off effects were over, the economy lacked oomph.

A cold caught from America? Partly. Although the slowdown in the United States has hurt European firms, the American-sneeze theory explains only part of the continent's problems, which are mostly home-grown. In fact, net exports (ie, exports less imports) have been helping to hold growth up. Imports have been growing even more slowly than exports, reflecting in turn soft domestic demand.

One possible cause of this is the interest-rate hikes, totalling 2¼ percentage points, that were prescribed by the European Central Bank in 1999 and 2000. So far this year, the ECB has reversed just a quarter-point of the increases. Another check on demand is rises in fuel and food prices late last year and early this, in the wake of higher crude-oil prices, mad-cow disease and foot-and-mouth. These made people loth to spend. As the economy has slowed, and they fear for their jobs, they have become even less keen.

The best bit of news is that most economists think that the third quarter will be better than the second. Whether they are right depends on Europe's consumers. Although industrial prospects look miserable for months yet, folk might start to spend now that the effects of last year's food and fuel price increases are fading. There are signs that German retail sales are picking up, perhaps helped by an income-tax cut at the start of the year: the recent scrapping of a law banning deep discounts in shops should help a little more. There may be more bad headlines ahead—watch for German GDP figures in two weeks' time—but the worst three months may already be over. And if that isn't so, the ECB may even be inclined to help.

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Economics focus

Averse to reality

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Economics relies on a standard theory of how people deal with risk. This theory is obviously wrong

A GREAT deal of economic theory turns on how people cope with risk—one of the least escapable facts of economic life. The model that most economists rely on when they need to take account of risk in their pure or applied research is expected-utility theory. The trouble is, this theory has implications so absurd that it cannot be true.

People are commonly observed to be "risk averse" in everyday life—that is, they reject better-than-fair gambles. Suppose you were offered a 50-50 bet that paid you $11 if you won and cost you $10 if you lost. Given the odds and the pay-offs, the expected return for accepting this bet is 50 cents (50% of $11 less 50% of $10); and since this is a positive number, the gamble looks attractive. The fact that many people do turn down such bets does not trouble expected-utility theory. It has an explanation: diminishing marginal utility. As your wealth rises, each extra dollar is worth less to you than the previous one. Because the utility of extra wealth declines, it is not necessarily illogical to attach a lower subjective value to the upside of the gamble (50% of $11) than to the downside (50% of $10). All seems well: the facts and the theory sit comfortably together.

Unfortunately, if you think about it, they do not, as Matthew Rabin of the University of California, Berkeley, and Richard Thaler of the University of Chicago point out in a recent article*. Consider the bet described in the previous paragraph, and imagine some unremarkably risk-averse person who turns it down. Now ask yourself this: knowing nothing else about the person, and assuming expected-utility theory to be true, how big a prize would you need to offer in a 50-50 bet to persuade him to risk losing $100?

Knowing he turned down the $11 prize, you might guess it would have to be more than $110. Would $220 be enough? The expected pay-off of that bet would be $60 (50% of $220 less 50% of $100). Looks good—yet our putative risk-avoider would still turn it down. Things get worse. What about $2,000? He would turn that down as well. All right, $20,000. No, still too risky. Very well, $2m; wait, what the heck, $2 billion. Still no. Given only what you know about this risk-avoiding person, plus the truth of expected-utility theory, you are forced to conclude that he will reject *any* 50-50 bet costing $100, regardless of the prize.

Risk-aversion of this degree is literally insane—yet rational, according to the theory. What is going on? To understand what the theory is doing, as Mr Rabin and Mr Thaler explain, you need to follow along with some arithmetic. Suppose that the person's initial wealth is W. Then rejecting the original lose-$10 gain-$11 bet implies that on average he values each of the dollars between W and (W + 11) by at most ten-elevenths of the average value he puts on dollars between W and (W - 10). This implies that the value he puts on the W + 11th dollar is at most ten-elevenths of the value he puts on the W - 10th dollar. In effect, then, our subject's marginal utility of wealth falls as his wealth rises, and rises as his wealth falls, at a rate of around 10% for every change of $21. This phenomenally powerful multiplier so inflates the value he attaches to a loss of $100, and so deflates the value he attaches to any gains, that no gain can be big enough to make the bet seem attractive.

The absurdity, as Mr Rabin and Mr Thaler emphasise, is not a trick reflecting particular assumptions, but is wired into the standard theory. "Expected-utility theory says risk attitudes derive solely from changes in marginal utility associated with fluctuations in lifetime wealth. Hence, the theory says that people will not be averse to risks involving monetary gains and losses that do not alter lifetime wealth enough to affect significantly the marginal utility one derives from that lifetime wealth." The theory, in other words, implies that people should be risk-neutral towards gambles involving small stakes—but they aren't.

Odds and ends

The question is, how to make sense of the fact that people will reject small-stake gambles and yet accept, as they are wont to, moderate-stake gambles provided the terms are good. The authors call for an approach based on two ideas (both mentioned on earlier occasions in this space): loss aversion and mental accounts.

Loss aversion is the idea that people feel the pain of a loss more acutely than the pleasure of a gain of equal size: changes in wealth, and their direction, are what count, regardless of levels. This directly explains why people turn down even very small gambles with positive expected gains. Mental accounting plays a complementary role. It is the idea that people judge financial risks in isolation, rather than alongside overall wealth and other risks. Small, better-than-fair gambles may look irresistible in relation to total wealth, because any losses will be negligible in that context; judged in isolation, especially given loss aversion, such gambles are much easier to turn down.

The authors argue that such decision isolation is pervasive, and explains many otherwise perplexing features of economic life—from the “equity-premium puzzle” to the otherwise contradictory facts that (a) lotteries are popular and (b) people are willing to pay outlandish prices to insure themselves against easily affordable losses (as with, for instance, optional extended warranties on consumer durables). The evidence against the expected-utility approach seems overwhelming, and the broad shape of an alternative, thanks to the earlier work of Mr Thaler and others, is reasonably clear. The greatest puzzle, perhaps, is that the old theory has not yet been discarded.

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*“Anomalies: Risk Aversion” By Matthew Rabin and Richard Thaler. Journal of Economic Perspectives, Volume 15, Number 1.

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Cosmology

Let there be light

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Astronomers may have glimpsed the edge of the visible—the fog that filled the universe before the first stars shone

ACCORDING to the Bible, all was darkness until God created light. But in the modern scientific story, light was created not once but twice. The first time was in the Big Bang, when the universe began its existence as a glowing, expanding fireball, which cooled off into darkness after a few million years. The second time was hundreds of millions of years later, when the cold material condensed into dense nuggets under the influence of gravity, and ignited to become the first stars.

Sir Martin Rees, Britain's astronomer royal, named the long interval between these two enlightenments the cosmic “Dark Age”. The name describes not only the poorly lit conditions, but also the ignorance of astronomers about that period. Nobody knows exactly when the first stars formed, or how they organised themselves into galaxies—or even whether stars were the first luminous objects. They may have been preceded by quasars, which are mysterious, bright spots found at the centres of some galaxies.

Now, two independent groups of astronomers, one led by Robert Becker of the University of California, Davis, and the other by George Djorgovski of the California Institute of Technology (Caltech), in Pasadena, claim to have peered far enough into space with their telescopes (and therefore backwards enough in time) to observe the closing days of the Dark Age.

Their results have not yet been published in scientific journals, and therefore have not been vetted by their colleagues for possible faults. But because these could be the first sightings of a whole new realm for astronomers to explore, the work is already receiving considerable attention.

Mists and mellow fruitfulness

The main problem that plagued previous efforts to study the Dark Age was not the lack of suitable telescopes, but rather the lack of suitable things at which to point them. Because these events took place over 13 billion years ago, if astronomers are to have any hope of unravelling them they must study objects that are at least 13 billion light-years away.

The best prospects are quasars, because they are so bright and compact that they can be seen across vast stretches of space. The energy source that powers a quasar is unknown, although it is suspected to be the intense gravity of a giant black hole. However, at the distances required for the study of the Dark Age, even quasars are extremely rare and faint.

The researchers overcame this problem by capitalising on the Sloan Digital Sky Survey, an international effort whose goal is to map out a large fraction of the sky and find the rare treasures within, using a custom-built telescope in New Mexico. Recently, some members of the Sloan team, led by Xiaohui Fan of Princeton University, announced their discovery of the four most distant quasars known.

All the new quasars are terribly faint, a challenge that both teams overcame by peering at them through one of the twin Keck telescopes in Hawaii. These are the world's largest, and can therefore collect the

most light.

The new work by Dr Becker's team (which includes Dr Fan and other Sloan scientists) analysed the light from all four quasars. Three of them appeared to be similar to ordinary, less distant quasars. However, the fourth and most distant, unlike any other quasar ever seen, showed unmistakable signs of being shrouded in a fog of hydrogen gas.

This gas is leftover material from the Big Bang that did not condense into stars or quasars. It acts like fog because new-born stars and quasars emit mainly ultraviolet light, and hydrogen gas is opaque to ultraviolet. Seeing this fog had been the goal of would-be Dark Age astronomers since 1965, when James Gunn and Bruce Peterson spelled out the technique for using quasars as backlighting beacons to observe the fog's ultraviolet shadow.

The fog prolonged the period of darkness until the heat from the first stars and quasars had the chance to ionise the hydrogen (breaking it into its constituent parts, protons and electrons). Ionised hydrogen is transparent to ultraviolet radiation, so at that moment the fog lifted, and the universe became the well-lit place it is today. For this reason, the end of the Dark Age is called the “Epoch of Re-ionisation”.

It is a significant milestone to have witnessed this epoch, and also to have measured exactly when it ended. Because the ultraviolet shadow is visible only in the most distant of the four quasars, the Sloan team concluded that the fog had dissipated completely by the time the universe was about 900m years old, and one-seventh of its current size.

Meanwhile, Dr Djorgovski and his group at Caltech learned about the process of fog dissipation by studying the closest of the four new quasars in more detail than the Sloan team. (They opened the shutter on the Keck telescope's camera for five and a half hours, compared with Dr Becker's 40 minutes.)

In the short exposure, there was no sign of an ultraviolet shadow cast by the fog of hydrogen gas. But in the longer exposure, the Caltech team saw there was indeed fog—but that it was patchy, like a morning mist being driven off by the sun.

Like visible light, ultraviolet light comes in hues that are defined by their wavelengths. However, only certain hues of ultraviolet were missing from the quasar's spectrum, rather than the whole range. The Caltech team deduced from this that the fog in this part of the universe was interrupted by large, transparent “bubbles” located at different distances along the line of sight to the quasar. Their reasoning depends on the fact that hydrogen gas is especially opaque to one particular wavelength. However, because the wavelength of light emitted by a quasar gradually grows as it travels through space (a consequence of the expansion of the universe), the relative position on the spectrum of this particular wavelength changes as the light travels. Each bank of fog between the bubbles, therefore, punches a different hole in the spectrum, as seen from earth.

These bubbles may reveal exactly how the Dark Age came to a close. After the first stars and quasars ignited, their radiation began pouring out into space, creating hot bubbles of ionised (and therefore transparent) gas around them. The bubbles grew and eventually merged, getting rid of all the un-ionised hydrogen.

Other scientists (Dr Becker among them) are sceptical of this interpretation, because similar patterns of patchy absorption, albeit much less opaque, have been seen in relatively nearby quasars—where they cannot be due to the primordial fog. It should not, however, be long before the disagreement is settled. First, this latest research will be scrutinised by other scientists. Then, within a few years, the Sloan survey should find about 1m new quasars, at least 20 of which are expected to be distant enough to provide additional probes to lighten the darkness of ignorance that surrounds the early universe.

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Marine biology

A new whale

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This animal is a male True's beaked whale. Although the species was identified almost 90 years ago from bodies washed up on shore, it has been seen alive only once before, in 1993. The photograph was taken from a ferry running between Britain and Spain, by Dylan Walker. Dr Walker is a whale biologist with a British research group called Organisation Cetacea, who was acting as a guide to a group of whale-watchers on the ferry when the animal appeared. Fortunately, he had his camera handy.

EPA

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The periodic table

10^{-15} seconds of fame

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An element apparently discovered two years ago has just been "undiscovered"

ADDING a new element to the periodic table is a guarantee of scientific immortality. So it was with much fanfare that physicists at Lawrence Berkeley National Laboratory (LBNL), in California, reported in 1999 that they had, for a fraction of a second, created two new elements which were the heaviest ever made. Now, in a surprising twist, they have said that the whole affair was an unfortunate mistake. Citing an inability to reproduce the original experiment, as well as a disappointing re-analysis of the data from it, the team's leader, Ken Gregorich, has sent a retraction of the claim to *Physical Review Letters*, the journal that first published it.

As these physicists can testify, life in the upper echelons of the periodic table of elements can be nasty, brutish and short. Uranium, with 92 protons in its nucleus, is the heaviest element that occurs naturally in any quantity. To make atoms heavier than that, physicists must bombard uranium with neutrons, or squash smaller atoms together. Even if a new element does form, it often disintegrates almost instantly.

The LBNL physicists thought they had caught a fleeting glimpse of element 118 because their detectors had picked up a tell-tale chain of six "alpha decays" occurring within one second. Alpha decay is a type of radioactivity that occurs when an unstable atom emits a helium nucleus (two neutrons and two protons). Since the number of protons distinguishes one element from another, element 118's alpha decay would have produced another never-before-seen species: an atom of element 116. This atom, in its turn, seemed to decay into an atom of element 114 (which had been created previously, but never in this fashion). The chain eventually terminated with element 106.

The supposed existence of element 118 was interesting to physicists for two reasons. Firstly, it appeared to vindicate the recipe used by the American team to make new sorts of atoms. The LBNL researchers sent a beam of relatively heavy krypton atoms hurtling into a target made of lead. Russian physicists, on the other hand, were using beams of light atoms, such as calcium, and smashing them into very heavy atoms such as plutonium or curium. Now, it seems the Russian technique may have been better all along.

More importantly, the experiment seemed to offer proof that an "island of stability" existed at the top end of the periodic table. Physicists think that nuclei are made up of concentric shells of protons and neutrons. A nucleus is particularly stable if it contains just the right number of protons and neutrons to fill its shells without gaps. Theorists believe that atoms ought to start experiencing stabilising shell effects in the region of the periodic table near element 114. Without such effects, an atom would have a half-life of only about a thousandth of a trillionth (10^{-15}) of a second. When element 118 popped up with an apparent half-life of 100 millionths of a second, the island of stability seemed to have materialised at last.

Now element 118 has been yanked unceremoniously off the charts. So what of the physicists' other efforts to make heavier atoms? The Russian researchers, who work at a laboratory in Dubna, have produced atoms of element 114 and 116 that have survived for many seconds at a stretch. So the island of stability itself is not a mirage. At Berkeley, an investigation is under way to find out what went wrong. With luck, the embarrassment at the laboratory will have a short half-life too.

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Organ repair

Hearts and minds

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An unusual strain of mouse suggests a way to regenerate damaged tissue

ONE of the reasons why biologists set so much store by research into stem cells is that they hope to use them to repair damaged tissue. In part, that is because mammalian (and therefore human) tissues are bad at repairing themselves. That is in contrast to, say, the tissues of amphibians. As is well known, these animals can regenerate entire amputated limbs.

One mammal, however, can perform amphibian-like regeneration tricks. This is a laboratory-bred strain of mouse known as MRL. In 1998 Ellen Heber-Katz, a researcher at the Wistar Institute in Philadelphia, showed that these mice, instead of creating scar tissue in response to injury, effected seamless repairs to damaged organs (in this case ears with holes punched in them). Now, Dr Heber-Katz and her mice are back. A paper in this week's *Proceedings of the National Academy of Sciences* describes her work. And this time, the self-repairing organ in question is one more critical to survival—the heart.

To inflict non-lethal heart damage on their mice, Dr Heber-Katz and her colleagues opened each animal up and applied a cold instrument to the organ. This injured the muscle of the right ventricle, one of the chambers that pumps blood.

The team then waited several weeks to see whether the damaged muscle would recover in either the MRL mice or the ordinary mice that underwent the same treatment, and thus served as controls. To some extent, it did so in both—but about ten times as many new muscle cells formed in the right ventricles of the MRL mice as in those of the controls. Also, there was little or no scarring in the hearts of the MRL mice, and within two months or so their heart function had returned to normal.

Laboratory mice are one thing; ailing people are quite another. To make practical use of this discovery it will be necessary to find out how the mice do it, and then devise drugs that will stimulate a similar process in people.

To this end, Dr Heber-Katz and her colleagues have traced the regenerative capacity of the MRL animals to a number of genes on five different mouse chromosomes. Using this knowledge, they believe they are poised to make further discoveries on the molecular level which could point to new therapies.

That would have implications for many medical conditions. Tissue death and scarring are features shared by a lot of diseases. Stimulating self-repair would thus have wide application. And not a single stem cell need be sacrificed along the way.

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Detecting landmines

Ratting on mines

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Most mine detectors make a buzzing noise. Some go squeak, squeak

PEOPLE who think of rats as vermin may wish to reconsider. With proper training, the animal could turn out to be man's best friend, at least if the man in question lives in an area with unmapped minefields. Apopo, a Belgian charity, is exploring the use of African giant pouched rats—prized hitherto only for their meat—as “biosensors” capable of locating landmines.

The idea of using animals to find mines is hardly new. Researchers have studied ways to harness bees' and cockroaches' keen senses of smell to detect explosives, and dogs are already used in de-mining work. But according to Ron Verhagen, the chief scientist at Apopo, rats offer a number of advantages when it comes to locating mines.

First, despite their impressive size for a rodent (25cm from nose to tail when full grown), they are too light to set off mines if they tread on them. They are also faster learners than dogs, and their behaviour is easier to decipher and control than an insect's. Unlike dogs, rats do not require the care and attention of a dedicated trainer. Since they live on a diet of nuts and fruit, they are cheaper to feed than their canine competitors. They are easier to house and transport than dogs, and being African animals, are immune to most of the tropical diseases that afflict imported dogs. The rats' only weakness is that they are nocturnal, and therefore prone to heat stroke.

To train their rats, Apopo's scientists blow air containing explosive traces at the animals. Using food rewards—bananas and avocados—the researchers have taught their rats to signal what they sniff by pushing levers. The 80 or so rats, known as Victor, Stefan, Nicholas and so on, are able to detect smaller amounts of explosive than most existing biosensors.

Apopo is exploring two ways of putting the rats to work. One would be to use the rats directly to detect landmines: they would be taught to scratch at the soil to indicate a mine. The alternative is the opposite idea, having the rats confirm areas to be free of mines. This would involve using mobile field laboratories, keeping the rats caged—and cool—and collecting soil samples for them to sniff for explosives.

Following two years of laboratory work in Belgium, Apopo scientists have now moved to Sokoine University of Agriculture in Tanzania, where they are conducting field tests with local scientists. The charity is also planning to conduct tests in Angola, in conjunction with Menschen gegen Minen, a German de-mining organisation. If all goes well, Victor, Stefan and their colleagues could graduate from providing protein to sweeping for mines within the next two years.

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Contemporary Chinese fiction

From mainland to mainstream

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There is no single authentic voice of Chinese fiction. And that may very well be a good thing

ONE clear fact emerged from the controversy over Gao Xingjian's Nobel prize for literature last October: an enormous—and increasingly hostile—divide exists between Chinese literature written and read in mainland China and that produced and consumed in the West. Chinese authors who went into exile in the 1980s, including Mr Gao, dominate perceptions of Chinese literature in western markets, but are largely ignored in China itself. Writers in China accuse the exiles of pandering to western fantasies about an exotically repressive China which is irrelevant to Chinese people today, while exiles denounce writers in China for selling out to the PRC's version of the market economy.

Whether a novel is written in China or in the West, dissidence is still the best recipe for hype: western audiences love whatever the Chinese government hates. Of the four books reviewed here, the only one written in China was “Shanghai Baby”, by Wei Hui (above right, followed clockwise by Annie Wang, Dai Sijie and Geling Yan). With its frank descriptions of sex and drugs in late-1990s Shanghai, it won widespread notoriety in China last year, and was eventually banned (a fact proudly advertised on its back cover, presumably to reassure the western reader that it must be worth buying). The book is now an international sensation, hailed as the hip new face of the Chinese avant-garde.

Despite all the spin, this semi-autobiographical novel falls somewhat flat in English. Its heroine, Coco, is a beautiful Shanghai novelist on a journey of self-discovery while she wavers between Tian Tian, her impotent Chinese boyfriend and Mark, her potent German lover. The novel features an array of eccentrically named minor characters (Flying Apple, Ah Dick), a hodge-podge of western cultural references (Henry Miller, “Titanic”) and well-expressed musings on Shanghai, but the focus never shifts too far from Coco's fascination with herself. Zhou Wei Hui, who, like Cher or Madonna, uses only her first name, claims to represent the 1970s generation, but one cannot but wonder how many Shanghai women have actually had sex with Germans in night-club toilets.

Ms Yan, who moved to San Francisco after 1989 but continues to write in Chinese, is herself no stranger to dissident marketing techniques: the “banned-in-China” formula was recently used to promote the film of one of her short stories, “Xiu Xiu: The Sent-Down Girl”. Yet the considerable appeal of her new novel, “The Lost Daughter of Happiness”, goes far beyond political exotica.

Shanghai Baby
By Wei Hui (translated by Bruce Humes)

Pocket Books; 288 pages; $24. Robinson; £6.99.

Buy it at
Amazon.com
Amazon.co.uk

The Lost Daughter of Happiness
By Geling Yan (translated by Cathy Silber)

Hyperion; 288 pages; $22.95. Faber and Faber; £9.99

Buy it at
Amazon.com
Amazon.co.uk

Lili: A Novel of Tiananmen
By Annie Wang

Pantheon; 307 pages; $24. To be published in Britain by Picador in January

Buy it at
Amazon.com
Amazon.co.uk

Balzac and the Little Chinese Seamstress
By Dai Sijie

Knopf; $18
Chatto & Windus; £12.99

Buy it at

The book tells the story of a celebrated Chinese prostitute, Fusang, who was abducted from south China to San Francisco in the 19th century. Against a backdrop of escalating racial violence between whites and Chinese, she becomes caught up between two men: her pimp, Da Yong, and Chris, a middle-class white boy who has been obsessed with her since adolescence. Despite these sensational ingredients, Ms Yan's unflinching narration of Fusang's career in the brutal San Francisco flesh trade does not offer the reader an easy hit of debauched chinoiserie, and Fusang remains inscrutable throughout.

Amazon.com
Amazon.co.uk

Generational as much as geographical factors divide contemporary Chinese literature. Although Ms Wang has lived in America since 1993 and writes in English, while Wei Hui still lives in Shanghai and writes in Chinese, both their books belong to the late 1990s phenomenon of “pretty woman literature”: glamorously photographed 20-something female authors who write about young women having sex at the margins of socialist society.

Despite these points of similarity, Ms Wang has used her political freedom to explore more serious historical questions. “Lili: A Novel of Tiananmen” follows the experiences of the beautiful young musician, Lili, from her traumatic childhood in the Cultural Revolution until the events of 1989. During the relative liberalisation of the post-Mao economic reforms, the disaffected Lili shocks her intellectual parents (“I love to upset those old Confucians”) by cohabiting with Roy, an American journalist. She argues repeatedly with Roy about his attempts to “save China”, until the pro-democracy movement of 1989 finally shakes her out of her cynicism. 1980s China, with its ossified socialism and burgeoning capitalism, is effectively evoked and Lili's scepticism is a thought-provoking foil to Roy's naive idealism.

Although Mr Dai left China in 1984 for France and writes in French, he also belongs to the “educated youth” generation in China: students relocated to China's rural hinterland during the Cultural Revolution (1966-76). Many writers of this generation subsequently built literary careers around these experiences; “Balzac and the Little Chinese Seamstress” is a welcome addition to this phenomenon. Set in 1971, Mr Dai's charmingly ingenuous narrative—more “Famous Five” than “Wild Swans”—contrasts intriguingly with the accounts of political violence familiar to western readers of Cultural Revolution memoirs. The narrator and his friend Luo are banished to Phoenix of the Sky, a remote fairytale-like mountain village, to be “re-educated” by hauling buckets of excrement and toiling in mines nearby. Life begins to look up when they come across the beautiful daughter of the local tailor and a secret cache of forbidden foreign books. This collection of European classics opens up an entrancing realm of literature denied them by years of communist indoctrination—with unexpected results for the little seamstress.

After China's re-entry into the international arena, it was hoped that a Chinese writer could one day win acclaim both in China and in the West. This hope was squashed by last year's Nobel award. After 13 years in exile, Mr Gao had been widely forgotten or ignored in the mainland. But the market for Chinese literature is sufficiently diverse to accommodate many definitions of literary success. Although Mr Gao and the other authors under review enjoy the prestige of western markets, most of them are largely peripheral to the native readership prized by mainland Chinese authors. Meanwhile, the respective strengths and weaknesses of literature written inside and outside China remain logically self-evident: those in the West enjoy greater freedom to write about politics and the recent past, while those in China have the day-to-day experience to write about the present. A book that combined the two would be real publishing news.

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About sponsorship

Tudor history

Hooray Henry

Aug 9th 2001
From The Economist print edition

HENRY VIII ruled England and its dominions between 1509 and 1547. His likeness, thanks to Holbein's famous portraits in the Thyssen-Bornemisza Museum and elsewhere, is so well known that it almost qualifies as a brand. A legend on account of his six wives, King Henry's legacy was substantial. The monarchy, Parliament and the Church of England were fundamentally reshaped by him, and survive in recognisable forms. During his quarrel with the pope, he declared England to be an “empire”, by which he meant a unitary sovereign state free from foreign jurisdiction. He was never a Eurosceptic, since he sought to conquer northern France and so extend his European influence, but his claims of national “sovereignty” would have been applauded by Lady Thatcher.

Henry VIII: The King and His Court
By Alison Weir

Ballantine Books; 608 pages; $28. Jonathan Cape; £20

Buy it at
Amazon.com
Amazon.co.uk

In the Lion's Court: Power, Ambition and Sudden Death in the Reigon of Henry VIII
By Derek Wilson

Hutchinson; 590 pages; £20

Buy it at
Amazon.co.uk

Henry VIII sells well, and his biography is once more up for grabs. The classic life by J.J. Scarisbrick first appeared in 1968, since when a huge volume of research has accumulated and tastes have changed. A gap exists in the market that Derek Wilson and Alison Weir have set out to fill. David Starkey, Elizabeth I's biographer, will follow in January.

Mr Wilson and Ms Weir both seek a fresh agenda in the politics and personalities of the royal court. Ms Weir opens vividly with descriptions of the splendours of royal palaces and ceremonies, sumptuously illustrated from the Household Ordinances and accounts, records of tournaments and the dispatches of ambassadors. This leads into a conventional political history, but the approach rings true, because monarchy was still highly personal. It was the charismatic, even sacral powers of the king, and not bureaucracy, that underpinned regality in the reign of Henry VIII, and such powers were concentrated in the Privy Chamber, the innermost sanctum of the court, and not in institutions such as the exchequer, the courts of law, or even Parliament.

Mr Wilson conceptualises the court less literally. He knows that accounts of revelry or expenditure on gourmet food and drink are ultimately antiquarian. They may be colourful, even voyeuristic—who ever knew that Henry VIII liked custard fritters or what he wore in bed?—but do such details illuminate politics? Since Mr Wilson aims to understand the hidden workings of power, he builds a new model for doing so. He rejects the clichéd “Henry VIII and his Six Wives” approach and opts instead for a different set of relationships. He tells the interlocking stories of six courtiers—all called Thomas—whose ambitions and principles brought them into close contact (and often collision) with the king, and which led them to violent deaths. He has to cheat a bit to engineer this result: neither Thomas Cranmer nor Thomas Wriothesley died in the reign of Henry VIII, and Thomas Howard, Duke of Norfolk, although condemned, was miraculously reprieved. Only Thomas More and his political rival, Thomas Cromwell, were actually executed by Henry VIII, and Cardinal Wolsey, who died of fright and dysentery a year after his ignominious disgrace, was the earliest victim.

Despite this artifice, Mr Wilson succeeds in recreating a sense of what Henry VIII was like and how power was deployed in his reign. His book has greater depth than Ms Weir's, but his style is dry and relentless. Ms Weir's is unquestionably livelier. Anachronistic analogies with modern personalities and events also blemish Mr Wilson's account, and his women tend to be cardboard characters. This is especially true of Anne Boleyn, the decisive influence in Henry's life and reign, and certainly the only woman he genuinely loved for any length of time. Page for page, Ms Weir's book is lighter of touch, but in the end we tire of so many incidental details and long for something more challenging.

At one point we seem to get it. In a suggestive passage, Ms Weir argues that Anne Boleyn was pregnant

when she was accused of multiple adultery and incest in the Privy Chamber in the spring of 1536. Writing to his ambassador, Richard Pate, in Rome, the king is said to have announced “the likelihood and appearance that God will send us heirs male”, implying he knew that Anne was once more expecting his child. If true, this would be a sensational discovery—in such circumstances, why did Henry ditch Anne?

Unfortunately, Ms Weir appears to have misread the document. In this particular letter, the reference to “heirs male” is not the king's, but constitutes reported speech: the words were those voiced by the Holy Roman Emperor, Charles V, in a separate letter to Cromwell from which Henry was quoting. The context (also explained elsewhere in the state papers) is that Charles wished the Princess Mary, Henry's daughter by his first wife Catherine of Aragon, to be restored to the order of succession, a request Charles believed to be reasonable given that Henry was still young enough to father a legitimate son. It is an unfortunate error that mars an otherwise enjoyable book.

Both these books have a market. Yet neither tells us much about English society, the state of the country, or the progress of the Reformation, although Mr Wilson does briefly mention Ireland. Neither convincingly explains why and how the “affable” king of the 1510s, whose palaces were described by Sir Thomas More as “more like a university than a court”, turned into such a vindictive monster. For the moment, Mr Scarisbrick's biography still holds sway. Despite its age, its nuanced interpretation of Henry's character is unsurpassed.

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About sponsorship

America, Canada and Mexico

And gone tomorrow?

Aug 9th 2001
From The Economist print edition

Here: A Biography of the New American Continent.
By Anthony DePalma.
PublicAffairs; 375 pages; $26

TIMING is often everything in politics. For several crucial months in 1993 the then Mexican president, Carlos Salinas de Gortari, managed to restrain the Chiapas uprising and keep any news of it out of the media until the House of Representatives had approved the North American Free-Trade Agreement by a narrow margin (234 votes to 200). When the violence that he feared might have frightened the Congress finally erupted less than two months later, on new year's day 1994, NAFTA had just come into effect.

Corbis

North of south

By contrast, having negotiated a broad reciprocal free-trade agreement with Washington in surprising haste during the winter of 1910-11, the Canadian prime minister, Sir Wilfrid Laurier, dallied eight months without pushing through the necessary legislation. He even sailed off part way through to attend King George V's coronation. The manufacturers and other Canadian protectionists had time to rally their forces, and Laurier lost his last election. If reciprocity had gone through in 1911, would Canada have become a very different country, either prospering in close harmony with the United States, or absorbed into it? Now, 90 years on, is history catching up?

Anthony DePalma pinpoints November 2000 as the month when his new continent and “our shared destiny” began to evolve. Vicente Fox, who had become Mexico's president in an extraordinary election, was about to take office, and George Bush and Jean Chrétien had both won elections north of the Rio Grande. Mr DePalma has his own perspective on history. He calls his epilogue “Symmetry Regained”, to suggest that NAFTA is transforming frontiers into mere seams stitching the three countries together as one in the way, he says, it was before the Spanish, French and British came. It will be all one “here” (with no “there”), he says, and, in deference to Mexican and Canadian feelings, he drops most references to Americans and calls its future inhabitants“Newlanders”.

From 1993 to 1999, Mr DePalma travelled widely in Mexico and Canada for the *New York Times*. Each chapter is a mixture of light sketches of those countries' political histories with anecdotes about his journeys and interviews as well as tales of his family coping in unfamiliar cities. He writes in ambassadorial style, sprinkling personal pronouns throughout, and aims to look through “a three-sided prism” and correct myths and mutual ignorance.

Yet, critical of his own country's “pennywhistle patriotism” in teaching history, he makes oddly shallow observations about the others. This is particularly striking with regard to Canada. For example, he says it played a small but important role in the second world war, a role that was short-lived before it settled down as “a Danny Kaye of sovereign nations”, likeable and relatively harmless.

Ignoring the 1932 Ottawa conference that launched “imperial preference” and how Canada had tried several times to negotiate trade reciprocity with the United States, Mr DePalma writes that, in signing the bilateral free-trade agreement in 1988, Brian Mulroney “dumped a century of deliberate economic isolation”. He adds, wryly but misleadingly, that he met only a handful of Canadians he thought were willing to die for their country. On the other hand, every one of the public telephones and parking meters he ever tried in Canadian cities was functioning.

Although Mr DePalma is now an international business reporter for his newspaper, there is little serious

discussion of the emerging consequences of NAFTA nor of the likelihood of dollarisation across the Americas. “Here” is a disappointing book, considering the author's special experience at a time of remarkable transition.

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Victims of Nazism

Closed accounts, open questions

Aug 9th 2001
From The Economist print edition

Where Did all the Money Go? The Pre-Nazi Era Wealth of European Jewry.
By Helen B. Junz.
HBJ International; 175 pages; £25

IN THE mid-1990s a belated but large-scale investigation into the fate of the assets and wealth of the largely Jewish victims of Nazi persecution began, in large part as a response to attacks on Swiss banks for their treatment of the victims and their heirs. The investigation was conducted at a number of levels of inquiry: by commissions of “eminent persons” nominated to arbitrate claims, by the major international accountancy firms, by national commissions of historians and other experts in many countries, by independent researchers and by journalists. In the course of the debate, very different kinds of figures were bandied about for the possible sums involved.

The particular value of Helen Junz's study is closely connected with its origins. It was produced at the request of the commission headed by Paul Volcker, a former chairman of the Federal Reserve Board, on the so-called dormant accounts in Swiss banks. The author was asked to find out how much Jewish-owned property there was, and in what form it had been held, in order to establish an upper bound for the amount that might have been transferred to supposed safety in Switzerland.

Ms Junz's study, which is argued with impeccable logic, rests on an impressive base in tax records and other hitherto unused archival material in six countries in which a large number of the victims of Nazism had lived: Austria, France, Hungary, Germany, the Netherlands and Poland. The Soviet Union, which also had a large number of victims, is not included, on the reasonable grounds that few Soviet citizens are likely to have had substantial assets that they could have rescued; while Czechoslovakia and Romania are excluded because of the unwillingness or inability of their governments and archival services to provide documents.

Ms Junz looks at the wealth of those citizens she can identify as Jewish on the basis of contemporary documents and is able to make informed estimates as to how that wealth was held: in commercial enterprises or in financial assets, a significant part of which was foreign (one of the surprises is how frequently individuals in the 1930s owned foreign securities). These are the assets that might well have been transferred out of the countries of residence, to safer institutions in neutral countries, or in Britain and America. Her overall conclusion is that just under $3 billion (in the prices of the time) “might have been available for transfer to, or already lodged in, a safe-haven destination”.

We still do not know how much of this money was actually transferred from the six countries under study (since the Nazis were very active in looting the assets they could find, and especially wanted to lay their hands on foreign securities). Nor do we know how much went to Switzerland, how much stayed there or and how much went on across the Channel or the Atlantic. In that sense, “Where did all the money go?” remains a crucial question that still demands an answer.

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Political art

Lumumba's light

Aug 9th 2001
From The Economist print edition

Congo's first prime minister still inspires writers, artists and film makers

Corbis

TIME was when Patrice Lumumba was regarded as a Soviet pawn. Forty years on, Congo's first prime minister has become an artist's muse and is about to enjoy his revenge on the Belgian establishment. Ludo de Witte's “The Assassination of Lumumba”—published in Flemish in 1999 and now, by Verso, in English—explained how the Belgian secret service carried out the murder in 1961 with a nod from Washington. The book inspired Raoul Peck, a Haitian film director, to finish his “Lumumba”, which has turned into an unusual hit in America. It also led a Flemish artist, Luc Tuymans, to centre “Mwana Kitoko”, his entry to this year's Venice Biennale, on the Congolese hero. All of which will mean an unusual level of interest in the Belgian commission of enquiry into the killing, which reports to Parliament in the autumn. Ah, the power of art.

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Mummification

It's a wrap

Aug 9th 2001
From The Economist print edition

MUMMIES are contradictory things: graceful and gruesome, embodying both death and immortality. They can provide snapshots of ancient lifestyles and customs, act as repositories of valuable medical data, and cause fierce academic controversies when the information they reveal about the past conflicts with modern expectations or political aims. Heather Pringle's book, inspired by her visit to an unusual conference known as the "Mummy Congress", is an engaging and wide-ranging survey of mummies throughout history and across the world.

The Mummy Congress
By Heather Pringle

Hyperion; 384 pages; $23.95. Fourth Estate; £15.99

Buy it at
Amazon.com
Amazon.co.uk

Although mummies are traditionally associated with ancient Egypt, the word is also applied to the Inca ice mummies of the Andes and desert mummies of Chile and China, self-mummified Japanese monks, Europeans preserved in bogs and glaciers, and the embalmed remains of medieval saints, kings and queens. It sounds like the stuff of dry, dusty scholarship, but Ms Pringle reanimates her subject with vivid portraits of the archaeologists, researchers and historians who have made the study of mummies their life's work, and whose enthusiasm for the subject quickly rubs off on the reader. She also skilfully links the study of mummies to present-day concerns such as the modern obsession with fitness, dieting and cosmetic surgery. More ominously, she reveals how mummified remains were used to justify slavery in the 19th century and the Nazi persecution of homosexuals and Serbian ethnic cleansing in the 20th.

The study of mummies raises many moral questions. Can detailed scrutiny of mummies, which is often destructive, be justified in the name of medical or historical research? Are modern archaeologists any better than looters and tomb robbers? Ms Pringle tackles these questions head on, examining the potential medical and academic benefits of some mummy research while admitting to her own unease. She explains how the discovery of mummies with Caucasian features in north-west China has pitted nationalists against western academics, and how efforts to film the retrieval of mummies from Andean mountain-tops caused a conflict between scientists and commercial interests. And she offers a balanced account of the controversial discovery of evidence of cocaine in Egyptian mummies.

The book is spiced with occasional flashes of humour, such as the tale of two Egyptians who ended up stored in a room under Tulane Stadium in New Orleans and inadvertently attended three Super Bowls, or the recurring nightmare of the Soviet scientist who embalmed Lenin and dreamed that he saw a fly buzzing around his sarcophagus. "The Mummy Congress" is fascinating without being sensationalist, comprehensive without being dull.

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Poetry slam

Declamation of independence

Aug 9th 2001 | NEW YORK
From The Economist print edition

Performance poetry is all the rage

INSIDE a decaying nightclub on East 3rd Street there's a riot going on. The beatniks are stacked three deep on the floor. Hipsters jostle for jiving room on the stairs. Gangstas gossip with geishas—the noise is outrageous. A quick-wristed bartender splashes cheap white wine into plastic cups; but nobody's really here to drink. This is the Nuyorican Poets' Café. They're here to listen to poetry. Friday night is slam night—and slam they will, by Apollo.

Slam, for the uninitiated, is the art of competitive performance poetry—think “Gladiator” rescripted in loosely rhyming couplets, with an inner-city, hip hop sensibility. But make no mistake. This isn't some East Village sideshow. The origins of slam can be traced back through the Beat movement of the 1950s and 1960s to the Harlem Renaissance of the 1920s. The first slams *per se* were organised in 1984 by a construction worker, Marc Smith, at the Get Me High Lounge in Chicago. Now, all over America, the slammers are coming out. This year's National Poetry Slam in Seattle—a six-day event which finished on August 5th—brought together 56 teams and more than 500 poets from across the country. The final round was attended by an estimated 2,500 slam enthusiasts.

Slam is no longer a subculture: it's part of a burgeoning spoken-word industry which includes sell-out nationwide book promotion tours, stand-up comedy and one-person theatrical productions. According to the *New York Times*, Barnes & Noble, America's largest bookselling chain, reported a 30% rise in poetry sales between 1997 and 2000, while another source, Poets House in New York, calculated that in 1999 alone some 989 books of poetry were published by 466 different publishers—an increase of almost 100% over 1993.

The order of ceremonies tonight at the Nuyorican is typical. Under the arbitration of slam-master Nathan P, the poets declaim, the judges judge, the audience hoots and stamps and roars. Bryonn Bain, a veteran slammer, kicks things off with a rapid-fire rumination on the predatory male gaze. Technically dazzling, super-confident, impeccably PC—a tough act to follow. But a young, slight Korean-American woman called Ishle Park rises to the challenge with an impassioned account of childhood alienation in Queens. Later, Edward Garcia takes the stage and strikes a similarly anguished pose. “Even the hunchbacked, one-eyed wheelchair kid shunned me”, he glumly recalls.

The preferred style of delivery is fast and furious, with heavy emphasis on internal rhymes and dramatic cadences—to the first-time listener slam sounds a lot like rap minus the backing musicians. It's a moot point whether it's the quality of the performance or the quality of the verse itself that matters most—in this low light, there's no separating the dancer and the dance. Like figure skaters or wet T-shirt contestants, the poets are scored on a nought-to-ten scale; the highest scorer wears the bays at the end of the night. Poetic justice in action.

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A showbiz life

Diamond Lil

Aug 9th 2001
From The Economist print edition

Mae West: An Icon in Black and White.
By Jill Watts.
Oxford University Press; 400 pages; $35 and £25

WHAT do you get if you mix the exuberant and curvaceous Mae West with an analytical professor? Egg on your face is what. As we do here. It is almost impossible for a narrowly correct stance on a most incorrect lady not to be absurd. Indeed, any Mae West biographer starts with a hefty handicap, since there already exists the star's own life-story, “Goodness Had Nothing To Do With It” (Manor Books, 1976), and a dozen other biographies.

Nonetheless, Jill Watts covers some intriguing issues. Did Mae have a black grandfather? Was her mother Jewish? Was Mae a man? Did she have an affair with Marlene Dietrich? And why, when she generously promoted the careers of Duke Ellington, Louis Armstrong and others, was she so reluctant to speak out against racial intolerance? The answers to the above questions are, in order: probably; probably but by the time she arrived in New York she had reinvented herself as a Lutheran; no; probably not, although she flirted with her; and who knows?

The story of her life takes in Brooklyn, burlesque, Broadway, and ultimately Hollywood, bootleggers and boxers. The constant themes are her battles against the censors—she had a short stint in jail in 1927—her adoption of black culture, jazz, the blues and, especially, the shimmy, her avowed promiscuity set against her childlessness, a loveless marriage to a small-time vaudevillian, and a regular pattern of critical failure followed by huge popular success. Her energy was extraordinary. Besides acting, singing and producing, and those extra-curricular activities which she claimed took up so much of her time, she wrote books and plays and films. In 1949 she was voted equal with Eleanor Roosevelt as “the most famous woman in the world”.

Ms Watts, who teaches history at California State University, takes the interesting view that as a “trickster” and “signifier”, Mae West appropriated black survival characteristics and lived the life of a black woman passing for white. But does this really catch what made her special? More telling, to this reviewer at least, is that, like Marilyn Monroe and Madonna, she was unashamedly working class, and it was this, more than her sex appeal, which endeared her to those who feel themselves to be excluded from American culture.

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About sponsorship

Eudora Welty

Aug 9th 2001
From The Economist print edition

A writer who plumbed the American South, died on July 23rd, aged 92

Reuters

HER appearance was deceptive. On acquaintance, Eudora Welty seemed a nice little old lady with impeccable manners, an impression reinforced by her ugly but endearing froggy face. Yet her writing revealed an entirely different person: the tough-minded woman with a shrewd eye and perfect ear whose always memorable, often violent stories helped change how non-southerners saw the American South.

It helped that Miss Welty was not exactly a southerner herself. She was born in Jackson, Mississippi, and her name was bracketed with those of Flannery O'Connor, William Faulkner, Tennessee Williams and Robert Penn Warren as a writer of the so-called Southern School, but she was only a first-generation southerner. Her father was from Ohio, her mother from West Virginia, a mountain state that seceded from Virginia. Like them, their daughter was almost wholly free of southern sentimentality, even when it concerned her hometown.

Others in Jackson still shudder when they recall the town being put to the torch by William Tecumseh Sherman, the Yankee general who went on to burn Atlanta to the ground. He and the retreating Confederates made such a good job of it that only the chimneys were left standing, and Jackson was known for long afterwards as Chimneyville. Miss Welty did not shudder. She instead regarded this civil-war atrocity as “kind of nice, a fresh start”.

But then instead of representing the South, Miss Welty tried to understand it. Her effort to do this really started when, after a spell as a student at New York's Columbia University School of Business and a few stabs at newspaper and radio journalism, she was hired as a publicist by the Works Progress Administration. The agency, established by President Franklin Roosevelt to create make-work jobs during the Great Depression, enabled her to visit all of Mississippi's 82 counties.

Seeing and listening

In her travels, Miss Welty, the product of an upper-class home with servants, was shocked by the poverty of the black sharecroppers and white dirt farmers she saw and talked to in rural Mississippi. Her snapshots of them were published nearly 40 years later in a book called “One Time, One Place: Mississippi in the Depression”. In their own way, they are as moving as “Let us now Praise Famous Men”, the classic series of Depression-era photographs taken by Walker Evans, a supreme professional. Above all, she was struck by the spirit of the poor of the Deep South and her pictures capture not just their suffering but also their dogged refusal to give way to despair.

It is a theme of some of her best fiction. In, for instance, “The Burning”, the only short story she wrote about the American Civil War, it is the southern damsels who are crushed by adversity. Their black maid remains indomitable.

Miss Welty's ear was as acute as her eye. In her longest novel, “Losing Battles”, she succeeds in her high ambition to create dialogue that has simultaneously “to reveal what the character said but also what he thought he said, what he hid, what others were going to think he meant, and what they misunderstood”.

As a citizen, she was a woman with strong political opinions. She always voted Democratic. Jimmy Carter was one of her “great southern heroes”. She despised Richard Nixon. But as a writer her answer was a resounding “No!” when, in a famous essay in the *Atlantic Monthly*, she posed the question: “Must the novelist crusade?” Fictional characters, she argued, were not right and wrong, good and bad, black and

white personified. The novelist worked neither to correct nor to condone, and not at all to comfort, but to make what's told alive.

“Writing fiction is an interior affair. Novels and stories always will be put down little by little out of personal feeling and personal beliefs arrived at alone and at first hand over a period of time as time is needed. To go outside and beat the drum is only to interrupt, interrupt, and so finally to forget and to lose. Fiction has, and must keep, a private address.”

Only once was she spurred into crusading. When Medgar Evers, a civil-rights activist, was shot dead in Jackson in 1963, she wrote, the following night, “Where is the Voice Coming From?”. She then sent it to the *New Yorker*, where the editor immediately recognised the story's worth and gutted the magazine to accommodate it.

Like all of Miss Welty's best work, it seeks to enter the mind and get under the skin of her characters, even those “alien and repugnant to me”. In a soliloquy, the killer confides his every thought as he plots and carries out the assassination.

Her characters are sometimes as grotesque as those of some other novelists of the Southern School. Her great achievement was to humanise them—and the South. Like Anton Chekhov, the Russian playwright and short-story teller to whom she is so often compared, she alchemised ordinary lives into great literature.

Miss Welty may have been a regional writer but she was never a provincial one. As one old friend says, with a sideswipe at Ernest Hemingway and William Faulkner, “She didn't have to go to Kilimanjaro or drink herself to death in Hollywood to have great ideas.”

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Overview

Aug 9th 2001
From The Economist print edition

America's “new economy” is neither a myth nor a miracle, according to revised productivity figures. Labour productivity grew at a 2.5% annual rate between 1996 and 2000, lower than the previous estimate of 2.8% but still much higher than the 1.4% growth rate of the previous 23 years. Productivity growth slowed to 1.6% in the year to the second quarter, its slowest rate for four years. Unit labour costs rose by 4.5% in the year to the second quarter, up from 4.3% in the previous quarter. America's unemployment rate unexpectedly held steady at 4.5% in July despite increasing layoffs. The Fed's “beige book” said the economy was still sluggish. The Dow Jones Industrial Average fell by 2.1% over the week.

More bad news from **Germany** this week. June manufacturing orders fell by 2.5%, partially reversing a 4.6% rise in May. Industrial output fell by 0.4% in June, leaving it only 1.1% higher than a year before. The number of people unemployed increased for the seventh consecutive month, although the jobless rate remained at 9.3%.

Japan's broad money supply growth accelerated to 3.3% in the year to July. Producer price inflation remained stable at 0.8% over the same period.

Britain's manufacturing slipped into recession, as output shrank for the second consecutive quarter. Total industrial production fell by 2.2% in the year to June, its worst performance since the 1991 recession.

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Output, demand and jobs

Aug 9th 2001
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2001	2002	1 year	1 year	latest	year ago
Australia	+ 4.3	+ 2.1 Q1	+ 2.6	+ 4.0	– 1.4 Q1*	+ 0.7 Q2	6.9 Jul	6.1
Austria	+ 1.6	+ 2.2 Q1	+ 1.8	+ 2.3	– 3.6 May	– 1.5 Apr	3.8 Jul	3.6
Belgium	+ 1.8	+ 2.4 Q1	+ 2.1	+ 2.4	– 2.9 May*	– 1.7 Apr	11.1 Jul*	11.2
Britain	+ 1.0	+ 2.1 Q2	+ 2.2	+ 2.7	– 2.2 Jun	+ 5.6 Jun	4.9 May‡	5.6
Canada	+ 2.5	+ 2.6 Q1†	+ 2.2	+ 3.1	– 0.7 May	+ 4.3 Apr	7.0 Jun	6.6
Denmark	– 4.6	+ 1.0 Q1	+ 1.4	+ 2.1	– 4.0 May	+ 0.2 Apr	5.2 Jun	5.4
France	+ 2.0	+ 2.7 Q1	+ 2.2	+ 2.4	+ 1.9 May	– 2.5 May	8.8 Jun	9.5
Germany	+ 1.5	+ 1.6 Q1	+ 1.2	+ 2.0	+ 1.1 Jun	– 2.3 May	9.3 Jul	9.5
Italy	– 0.5	+ 2.0 Q2	+ 2.0	+ 2.3	– 3.1 Jun	– 1.2 May	9.6 Apr	10.7
Japan	– 0.8	– 0.1 Q1	– 0.5	+ 0.7	– 8.7 Jun	– 1.0 May	4.9 Jun	4.7
Netherlands	+ 0.2	+ 2.0 Q1	+ 2.0	+ 2.8	– 2.0 May	+ 1.5 Mar	1.8 Jun§	2.7
Spain	+ 4.1	+ 3.3 Q1	+ 2.7	+ 2.9	– 0.4 May	na	12.8 Jun	14.2
Sweden	+ 2.4	+ 2.3 Q1	+ 2.2	+ 2.7	– 1.4 Apr	+ 1.9 May	4.2 Jun*	5.1
Switzerland	+ 7.4	+ 2.5 Q1	+ 1.7	+ 2.0	+ 5.1 Q1*	– 0.7 May	1.7 Jul*	1.8
United States	+ 0.7	+ 1.3 Q2	+ 1.6	+ 2.7	– 3.6 Jun	+ 2.5 Apr	4.5 Jul	4.0
Euro area	+ 2.0	+ 2.5 Q1	+ 1.9	+ 2.3	– 0.1 May	+ 0.5 May	8.3 Jun	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 0.4	+ 3.4 Q1	na	na	– 3.0 Jun	+ 4.2 Apr	9.3 Jun*	10.3
Greece	na	+ 2.52000	na	na	– 0.8 Mar*	+ 5.1 Mar	na	na
Iceland	na	+ 3.62000	na	na	+ 2.5 2000	na	1.5 Apr	1.5
Ireland	na	+12.1 Q4	na	na	+ 3.2 May*	+ 0.7 May	3.6 Jul	4.0
Luxembourg	na	+ 8.52000	na	na	– 1.6 Apr*†	+ 9.1 Jun	2.4 Jun	2.7
New Zealand	+ 0.9	+ 0.4 Q1	na	na	+ 0.9 Q1*	+ 7.2 Q2	5.2 Q2	6.1
Norway	+ 0.9	+ 0.3 Q1	na	na	– 0.1 Jun*	– 1.8 May	3.6 Q2	3.3
Portugal	– 0.3	+ 2.2 Q1	na	na	+ 3.4 May*	+ 6.4 Apr	4.2 Q1	4.4

*Not seasonally adjusted. †New series. ‡Mar-May; claimant count rate 3.2% in Jun. §Apr-Jun

Text refers only to the first 16 countries listed

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Prices and wages

Aug 9th 2001
From The Economist print edition

% change at annual rate

	Consumer prices*			The Economist poll consumer prices forecast		Producer prices*			Wages/earnings		
	1 year		year ago	2001	2002	1 year		year ago	1 year		year ago
Australia	+ 6.0	Q2	+ 3.2	+ 3.9	+ 2.4	+ 5.6	Q2	+ 7.4	+ 5.6	Q1	+ 2.9
Austria	+ 2.8	Jun	+ 2.7	+ 2.5	+ 1.8	+ 1.9	Jul	+ 4.6	+ 2.7	Jun	+ 2.0
Belgium	+ 2.7	Jul	+ 2.8	+ 2.6	+ 2.0	+ 5.3	May	+ 8.6	+ 2.6	Q2	+ 2.2
Britain	+ 1.9	Jun	+ 3.3	+ 2.1	+ 2.4	+ 0.4	Jun	+ 2.8	+ 4.5	May	+ 4.6
Canada	+ 3.3	Jun	+ 2.9	+ 2.8	+ 2.1	+ 1.7	Jun	+ 5.7	+ 0.5	May	+ 3.2
Denmark	+ 2.3	Jun	+ 3.3	+ 2.4	+ 2.1	+ 3.2	Jun	+ 6.6	+ 3.8	Q1	+ 3.6
France	+ 2.1	Jun	+ 1.7	+ 1.8	+ 1.5	+ 2.3	Jun	+ 6.0	+ 4.3	Q1	+ 5.2
Germany	+ 2.6	Jul	+ 1.9	+ 2.7	+ 1.7	+ 3.1	Jun	+ 5.4	+ 1.8	May*	+ 2.1
Italy	+ 2.9	Jul	+ 2.6	+ 2.8	+ 2.0	+ 2.3	Jun	+ 6.9	+ 2.7	Jun*	+ 1.8
Japan	– 0.5	Jun	– 0.7	– 0.4	– 0.4	+ 0.8	Jul	– 0.4	+ 0.9	Jun	+ 2.8
Netherlands	+ 4.5	Jun	+ 2.7	+ 4.6	+ 2.7	+ 4.3	Jun	+ 8.8	+ 4.3	Jun	+ 3.2
Spain	+ 4.2	Jun	+ 3.4	+ 3.7	+ 2.8	+ 2.4	Jun	+ 5.8	+ 2.2	Q4	+ 2.4
Sweden	+ 2.9	Jun	+ 1.2	+ 2.3	+ 1.8	+ 2.2	Jun	+ 3.7	+ 2.7	May*	+ 1.9
Switzerland	+ 1.4	Jul	+ 1.9	+ 1.3	+ 1.3	+ 0.4	Jun	+ 2.9	+ 1.3	2000	+ 0.3
United States	+ 3.2	Jun	+ 3.7	+ 3.2	+ 2.2	+ 2.5	Jun	+ 4.4	+ 4.4	Jul	+ 3.6
Euro area	+ 3.0	Jun	+ 2.4	+ 2.8	+ 1.9	+ 3.3	Jun	+ 5.6	+ 2.6	Q1	+ 2.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 3.0	Jun	+ 3.5	na	na	+ 2.4	Jun	+ 8.6	+ 5.0	Q1*	+ 3.5
Greece	+ 3.9	Jun	+ 2.5	na	na	+ 5.1	Apr	+ 7.0	na		na
Iceland	+ 7.0	Jul	+ 5.6	na	na	+ 6.7	Jul	+ 3.6	+ 8.2	Jun	+ 7.6
Ireland	+ 5.3	Jun	+ 5.5	na	na	+ 3.0	Jun	+ 5.5	+ 6.4	Q4*	+ 7.3
Luxembourg	+ 2.9	Jun	+ 3.3	na	na	+ 1.1	May	+ 5.5	+ 7.7	Apr*	– 1.0
New Zealand	+ 3.2	Q2	+ 2.0	na	na	+ 7.8	Q1	+ 4.9	+ 1.8	Q1	+ 1.4
Norway	+ 3.8	Jun	+ 3.3	na	na	+ 3.5	Jun	+ 8.3	+ 4.4	Q1*	+ 4.1
Portugal	+ 4.5	Jun	+ 2.9	na	na	+ 4.2	Jun	+16.2	+ 2.4	Apr*	na

*Not seasonally adjusted.

Text refers only to the first 16 countries listed

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Economic forecasts

Aug 9th 2001
From The Economist print edition

Every month *The Economist* surveys a group of economic forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and the euro area. The table also shows the highest and lowest projections for economic growth. The previous month's forecasts, where different, are shown in brackets. The panel now expects a somewhat sharper recession in Japan this year and a more modest recovery in 2002. It has left unchanged its forecasts for growth this year in the United States and the euro area. However, it has lowered them for 2002. In contrast, the panel has become more optimistic about the outlook for economic growth in Australia, both this year and next. It is forecasting somewhat higher inflation in 2001 in the euro area, particularly in Austria and Belgium.

August averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2001	2002	2001	2002	2001	2002	2001	2002
Australia	1.8/3.5	3.3/4.5	2.6 (2.3)	4.0 (3.8)	3.9 (4.0)	2.4	−2.9 (3.0)	−3.1 (−3.0)
Austria	1.4/2.3	2.0/2.6	1.8 (2.0)	2.3	2.5 (2.3)	1.8 (1.7)	−2.3(−2.2)	−2.2 (−2.0)
Belgium	1.8/2.5	2.0/3.0	2.1 (2.3)	2.4 (2.6)	2.6 (2.4)	2.0 (1.9)	4.3 (4.2)	4.5
Britain	1.9/2.4	2.4/3.1	2.2	2.7 (2.8)	2.1	2.4	−1.8(−2.1)	−2.1 (−4.0)
Canada	1.5/3.2	2.0/4.1	2.2 (2.3)	3.1	2.8	2.1	3.1 (3.3)	2.4 (2.6)
Denmark	0.7/1.9	1.7/2.4	1.4 (1.5)	2.1	2.4	2.1 (2.2)	1.4 (1.6)	1.4 (1.7)
France	2.1/2.4	2.2/2.8	2.2	2.4 (2.5)	1.8	1.5	1.6 (1.7)	1.6 (1.8)
Germany	0.7/1.5	1.6/2.5	1.2 (1.3)	2.0 (2.1)	2.7	1.7	−1.0(−0.8)	−0.8 (−0.6)
Italy	1.6/2.2	1.7/2.7	2.0	2.3	2.8 (2.7)	2.0 (2.1)	−0.3	−0.2 (−0.1)
Japan	−1.1/0.4	−0.2/1.7	−0.5 (−0.3)	0.7 (0.9)	−0.4	−0.4 (−0.3)	2.2	2.1 (2.0)
Netherlands	0.8/2.5	2.2/3.5	2.0 (2.2)	2.8 (2.9)	4.6	2.7	3.9 (4.1)	3.9 (4.0)
Spain	2.3/3.0	2.5/3.5	2.7	2.9	3.7	2.8	−2.8	−2.3 (−2.7)
Sweden	1.8/3.0	2.1/3.4	2.2 (2.3)	2.7 (2.8)	2.3 (2.2)	1.8	2.1	2.3
Switzerland	1.5/2.2	1.6/2.8	1.7 (1.8)	2.0 (2.1)	1.3	1.3	11.0(11.5)	10.8 (11.5)
United States	1.0/1.8	1.0/3.7	1.6	2.7 (2.9)	3.2	2.2 (2.3)	−4.1	−4.0 (−3.9)
Euro area	1.6/2.1	2.0/2.7	1.9	2.3 (2.4)	2.8 (2.7)	1.9	−0.2(−0.3)	−0.1

Sources: ABN Amro, Deutsche Bank, EIU, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan, Morgan Stanley Dean Witter, Nordbanken, Decision Economics, Royal Bank of Canada, Salomon Smith Barney, Scotiabank, Shinsei Bank, Warburg Dillon Read.

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Money and interest rates

Aug 9th 2001
From The Economist print edition

Money and interest rates

	Money supply* % change on year ago			Interest rates % p.a. (Aug 8th 2001)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+15.8	+ 7.0	Jun	5.05	6.39	5.31	6.00	6.10	7.50
Britain	+ 6.7	+ 7.5	Jun	4.94	6.13	5.01	4.91	5.21	6.20
Canada	+10.5	+ 6.6	Jun	4.02	5.62	4.53	5.61	5.75	7.20
Denmark	+ 1.2	- 6.9	May	4.80	5.58	4.63	5.11	5.54	7.07
Japan	+ 8.7	+ 3.3	Jul	0.02	0.10	0.10	1.37	1.71	1.56
Sweden	+ 7.2	+ 5.0	Jun	4.29	4.06	4.55	5.17	5.23	5.36
Switzerland	nil	+ 3.6	Jun	3.19	3.38	3.33	3.29	3.89	4.08
United States	+ 1.6	+11.3	Jun	3.51	6.49	3.75	5.06	5.91	6.94
Euro area†	+ 4.2	+ 6.3	Jun	4.43	4.84	4.14	4.84	5.10	5.46

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 5.38%, Japan No.233 1.37%. Central bank rates: US fed funds 3.75%, ECB refinancing 4.50%, BOJ overnight call 0.01%, BOE repo 5.00%.
Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, OM Fixed Income Exchange, Warburg Dillon Read, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Aug 9th 2001
From The Economist print edition

1995=100

	Jul 31st	Aug 7th*	% change on one month	% change on one year
Dollar index				
All items	69.3	68.3	– 1.0	– 4.2
Food	70.6	69.4	+ 0.8	+ 0.9
Industrials				
All	67.5	66.8	– 3.4	–10.5
Nfa†	67.7	68.0	– 0.4	– 0.9
Metals	67.3	65.8	– 5.9	–17.5
Sterling index				
All items	76.7	76.3	– 1.0	+ 2.2
Euro index				
All items	104.1	102.4	– 3.4	– 1.7
Yen index				
All items	92.0	90.0	– 2.3	+ 9.1
Gold				
$ per oz	266.15	266.45	– 0.4	– 2.5
West Texas Intermediate				
$ per barrel	26.74	28.13	+ 3.2	– 5.7

* Provisional. † Non-food agriculturals.

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Stockmarkets

Aug 9th 2001
From The Economist print edition

Market indices

	Aug 8th	2001 high	2001 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,344.1	3,425.2	3,094.3	+ 0.8	- 2.4	+ 6.0	- 1.3
Austria (ATX)	1,219.1	1,245.8	1,052.2	- 1.4	-29.8	+13.6	+ 6.0
Belgium (Bel 20)	2,924.4	3,030.4	2,591.6	- 0.7	-20.6	- 3.3	- 9.7
Britain (FTSE 100)	5,476.5	6,334.5	5,275.7	- 1.3	-21.0	-12.0	-16.7
Canada (Toronto Composite)	7,654.2	9,348.4	7,415.5	- 1.1	-32.8	-14.3	-16.0
Denmark (KBX)	253.8**	311.5	234.7	- 3.3	-15.9	- 4.1	-10.3
France (SBF 250)	3,211.2	3,820.2	3,084.7	- 2.0	-26.9	-14.8	-20.5
(CAC 40)	4,986.2	5,998.5	4,773.2	- 2.5	-28.0	-15.9	-21.5
Germany (Xetra DAX)	5,614.5	6,795.1	5,388.0	- 3.8	-30.4	-12.7	-18.5
Italy (BCI)	1,611.1	1,948.4	1,555.8	+ 0.0	-26.2	-15.9	-21.5
Japan (Nikkei 225)	12,163.7	14,529.4	11,579.3	+ 1.7	-68.7	-11.8	-18.1
(Topix)	1,217.9	1,441.0	1,162.0	+ 0.9	-57.8	- 5.1	-11.9
Netherlands (AEX)	540.6	642.3	518.3	- 2.0	-22.9	-15.2	-20.9
Spain (Madrid SE)	825.8	963.9	798.6	- 0.8	-28.0	- 6.2	-12.5
Sweden (Affarsvarlden Gen)	227.9	293.1	217.2	- 2.5	-43.1	-17.9	-25.8
Switzerland (Swiss Market)	6,875.7	8,135.4	6,574.0	- 0.6	-18.3	-15.5	-20.3
United States (DJIA)	10,293.5	11,337.9	9,389.5	- 2.1	-12.2	- 4.6	- 4.6
(S&P 500)	1,183.5	1,373.7	1,103.3	- 2.7	-22.5	-10.4	-10.4
(Nasdaq Comp)	1,966.4	2,859.2	1,638.8	- 4.9	-61.1	-20.4	-20.4
Europe (FTSE Eurotop 300)*	1,321.8	1,545.5	1,279.0	- 2.0	-22.5	-13.8	-19.6
Euro area (FTSE Ebloc 100)*	1,173.1	1,404.1	1,139.8	- 2.5	-24.3	-15.7	-21.4
World (MSCI)†	1,055.6	1,249.2	1,014.6	- 1.9	-27.1	na	-13.6
World bond market (Salomon)‡	436.3	447.8	420.6	+ 0.3	- 5.1	na	- 1.7

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Salomon Smith Barney World Government Bond Index, total return, in dollar terms. **New index.

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Trade, exchange rates and budgets

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From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2001	2002	Exchange rate trade-weighted† Aug 8th	year ago	Currency units per $ Aug 8th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2001‡
Australia	− 0.1	Jun	− 12.9	Q1	− 2.9	− 3.1	72.8	76.8	1.93	1.73	2.73	1.69	1.57	0.1
Austria	− 5.6	Apr	− 4.7	May	− 2.3	− 2.2	100.1	99.4	15.7	15.3	22.2	13.8	12.8	-0.6
Belgium	+ 12.1	May	+ 11.2	Mar	+ 4.3	+ 4.5	98.7	97.9	46.0	44.9	65.1	40.3	37.4	0.7
Britain	− 44.0	May	− 19.2	Q1	− 1.8	− 2.1	105.5	108.7	0.71	0.67	–	0.62	0.57	1.2
Canada	+ 48.2	May	+ 22.2	Q1	+ 3.1	+ 2.4	78.7	80.2	1.53	1.48	2.16	1.34	1.24	2.6
Denmark	+ 6.7	May	+ 4.3	May	+ 1.4	+ 1.4	101.7	99.7	8.49	8.31	12.0	7.44	6.90	2.9
France	− 0.2	May	+ 14.0	May	+ 1.6	+ 1.6	101.2	100.5	7.49	7.31	10.6	6.56	6.08	-0.5
Germany	+ 57.4	May	− 17.4	May	− 1.0	− 0.8	98.1	97.1	2.23	2.18	3.16	1.96	1.81	-1.7
Italy	+ 3.3	May	− 6.1	Apr	− 0.3	− 0.2	72.2	71.8	2,210	2,157	3,124	1,936	1,796	-1.3
Japan	+ 95.6	May	+102.3	May	+ 2.2	+ 2.1	138.0	154.6	123	108	174	108	–	-6.3
Netherlands	+ 17.8	May	+ 16.0	Q1	+ 3.9	+ 3.9	97.5	96.6	2.51	2.46	3.56	2.20	2.04	1.3
Spain	− 38.2	May	− 15.9	Apr	− 2.8	− 2.3	74.0	73.4	190	185	268	166	154	nil
Sweden	+ 12.8	Jun	+ 5.7	May	+ 2.1	+ 2.3	76.0	83.1	10.44	9.27	14.8	9.15	8.48	3.6
Switzerland	+ 0.1	Jun	+ 28.3	Q1	+11.0	+10.8	109.2	105.3	1.72	1.72	2.43	1.51	1.40	na
United States	−455.5	May	−449.3	Q1	− 4.1	− 4.0	119.6	112.3	–	–	1.41	0.88	0.81	2.1
Euro area	− 1.2	May	− 30.6	May	− 0.2	− 0.1	77.9	77.0	1.14	1.11	1.61	–	0.93	-0.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.8	May	+ 8.9	May	na	na	77.8	76.1	6.91	6.62	9.77	6.06	5.62	5.3
Greece	− 7.5	Jan	− 7.7	Jan	na	na	57.3	57.4	396	375	560	347	322	nil
Iceland	− 0.4	Jun	− 0.9	Q1	na	na	na	na	103	80.3	146	90.3	83.7	2.4
Ireland	+ 28.3	May	− 1.3	Q1	na	na	86.9	85.6	0.92	0.88	1.29	0.80	0.74	4.5
Luxembourg	− 2.4	Apr	+ 1.2	Q1	na	na	98.7	97.9	46.9	44.9	66.3	41.1	38.1	3.6
New Zealand	nil	Jun	− 2.3	Q1	na	na	80.5	80.5	2.41	2.22	3.41	2.11	1.96	1.0
Norway	+ 27.8	Jun	+ 25.6	May	na	na	95.8	92.0	9.19	9.02	13.0	8.05	7.47	15.3
Portugal	− 13.9	Apr	− 9.6	May	na	na	89.1	88.4	233	223	330	204	189	-1.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.

Text refers only to the first 16 countries listed

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Small stockmarkets

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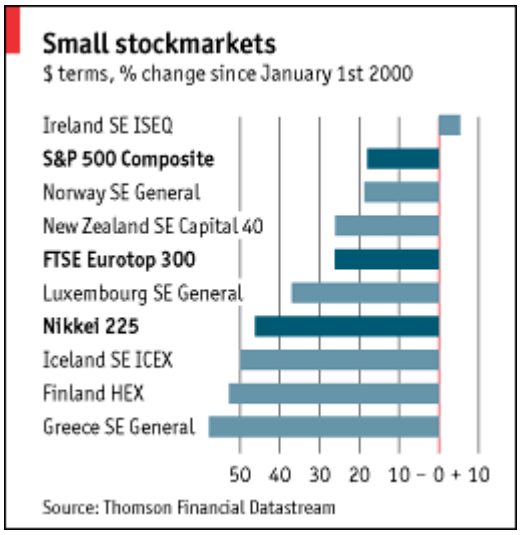
From The Economist print edition

The stockmarkets of small developed economies have plummeted alongside their larger counterparts over the past 20 months. The exception is the Irish stockmarket, which has gained 5%. The Finnish and Greek markets have tumbled by more than 50%.



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Overview

Aug 9th 2001
From The Economist print edition

Argentina's total international reserves dropped again this week to $20.3 billion; they have now fallen by 40% from their peak in July 2000. However, hopes of a new aid package from the IMF caused the spread between Argentine government bonds and US Treasuries to fall by 113 basis points to 1,471. Meanwhile, a $15 billion credit line from the IMF calmed markets in **Brazil**. The Bovespa stockmarket index was virtually unchanged over the week, and the *real* strengthened slightly to 2.47 to the dollar.

Peru's GDP fell by 2.3% in the year to June. The official GDP growth goal set with the IMF is 1.5% for this year. Analysts expect growth of 0.3% at best.

Thailand's stockmarket soared by 7.5% this week, as investors hoped that economic prospects would improve after the prime minister was cleared of corruption.

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Stockmarket turnover

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A stockmarket's turnover ratio measures how often shares change hands. Some emerging economies have very high turnover. Pakistan had a ratio of 487% of market capitalisation in 2000: ie, on average, each share changed hands almost five times. South Korea, Taiwan and India all had ratios above 300%. The United States had a ratio of 200%. At the other extreme, Argentina's turnover ratio was below 5%.

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Economy

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	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.8	Q2	+ 8.1	Jul	+ 1.4	Jun	+19.9	Jun	+20.5	2000	180.2	Apr
Hong Kong	+ 2.5	Q1	– 0.1	Q1	– 1.1	Jun	–11.9	May	+ 8.8	Q1	114.6	Jul
India	+ 5.7	Q3	+ 1.9	May	+ 2.5	May	– 5.3	Jun	– 2.3	Q1	40.6	Jun
Indonesia	+ 4.0	Q1	+ 4.5	Q4	+13.0	Jul	+24.8	Jun	+ 5.5	Q3	27.9	Jun
Malaysia	+ 3.2	Q1	– 9.9	Jun	+ 1.5	Jun	+15.3	Jun	+ 8.4	Q4	25.6	Jun
Philippines	+ 2.5	Q1	+ 2.0	May	+ 6.8	Jul	+ 6.1	May	+ 8.5	Apr	12.5	May
Singapore	– 0.8	Q2	–16.1	Jun	+ 1.2	Jun	+ 7.7	Jun	+21.8	Q1	76.0	May
South Korea	+ 3.7	Q1	– 2.7	Jun	+ 5.0	Jul	+14.0	Jul	+13.8	Jun	94.3	Jun
Taiwan	+ 1.1	Q1	–11.3	Jun	+ 0.1	Jul	+12.2	Jun	+12.0	Q1	109.1	Jun
Thailand	+ 1.8	Q1	+ 1.7	Jun	+ 2.2	Jul	+ 3.1	Jun	+ 6.9	Jun	31.0	Jun
Argentina	– 2.1	Q1	– 2.9	Jun	– 1.0	Jul	+ 2.3	Jun	– 9.0	Q1	21.1	Jun
Brazil	+ 4.1	Q1	+ 4.2	May	+ 8.1	Jun	– 1.6	Jul	–26.8	Jun	37.3	Jun
Chile	+ 3.3	Q1	+ 6.3	Jun	+ 3.2	Jul	+ 1.7	Jun	– 1.4	Q1	14.3	Jun
Colombia	+ 1.7	Q1	+ 2.2	May	+ 8.1	Jul	+ 1.5	May	– 0.7	Q1	9.3	Jun
Mexico	+ 1.9	Q1	– 3.4	May	+ 6.6	Jun	– 9.5	Jun	–17.8	Q1	40.7	Jun
Peru	– 2.3	Jun	+ 1.3	May	+ 2.2	Jul	– 0.3	May	– 1.7	Q1	8.3	May
Venezuela	+ 3.5	Q1	na		+13.0	Jul	+17.2	Dec	+12.5	Q1	10.5	Jun
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.2	May	–10.4	Q4	– 0.8	Q4	13.0	Apr
Israel	+ 1.8	Q1	+ 0.3	Apr	+ 0.7	Jun	– 7.4	Jun	– 1.1	Q1	22.8	Jun
South Africa	+ 2.7	Q1	+ 3.1	Jun	+ 6.3	Jun	+ 4.1	Jun	+ 0.1	Q1	6.1	Jun
Turkey	– 1.9	Q1	–10.4	Jun	+56.3	Jul	–22.8	May	– 5.4	May	16.6	Jun
Czech Republic	+ 3.8	Q1	+ 6.9	May	+ 5.9	Jul	– 3.4	Jun	– 2.7	Q1	12.7	Jun
Hungary	+ 4.4	Q1	nil	Jun	+10.5	Jun	– 2.4	Jun	– 1.7	Jun	11.5	Jun
Poland	+ 2.3	Q1	– 4.8	Jun	+ 6.2	Jun	–10.1	Jun	– 7.2	Jun	26.2	Jun
Russia	+ 4.9	Q1	+ 3.7	Jun	+22.2	Jul	+59.7	May	+45.9	Q1	31.3	Jun
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 5.6	2000†	–12.9	Dec	+ 3.6	May	– 1.5	Jun	– 1.1	2000†	1.3	May
Saudi Arabia	+ 4.5	2000‡	na		– 0.2	May	+50.9	2000	+15.6	2000	17.1	Jun

*Excluding gold, except Singapore; IMF definition. ‡ Economist Intelligence Unit estimate. †Year ending June.

Text refers only to the first 25 countries listed

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Financial markets

Aug 9th 2001
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Aug 8th		Dec 31st 2000	
	Aug 8th	year ago	Aug 8th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	11.7	na	1,984.7	-4.4	-9.5	-9.5
Hong Kong	7.80	7.80	11.0	3.55	11,958.0	-4.2	-20.8	-20.8
India	47.1	45.3	66.7	7.08	3,302.3	+0.6	-16.9	-17.7
Indonesia	9,330	8,810	13,192	17.35	442.5	-0.2	+6.3	+10.2
Malaysia	3.80	3.80	5.37	3.30	656.8	-0.9	-3.4	-3.4
Philippines	53.2	44.8	75.2	11.38	1,308.4	-1.9	-12.5	-17.7
Singapore	1.78	1.73	2.51	2.40	1,641.9	-2.5	-14.8	-16.8
South Korea	1,280	1,116	1,810	5.10	565.9	+0.6	+12.2	+10.8
Taiwan	34.6	31.1	48.9	3.90	4,514.1	+3.7	-4.8	-9.0
Thailand	45.4	40.8	64.2	3.00	323.1	+7.5	+20.0	+14.7
Argentina	1.00	1.00	1.41	12.09	319.1	+3.9	-23.5	-23.5
Brazil	2.47	1.79	3.50	18.89	13,930.7	+1.4	-10.7	-29.6
Chile	682	550	964	4.46*	5,522.4	+1.1	+13.4	-4.5
Colombia	2,298	2,172	3,249	12.66	980.3	-0.3	na	na
Mexico	9.10	9.35	12.9	7.24	6,651.4	+1.2	+17.7	+24.3
Peru	3.50	3.48	4.9	7.90	1,347.0	+0.7	+11.5	+12.4
Venezuela	731	688	1,033	13.07	7,258.0	-2.9	+6.8	+2.3
Egypt	4.22	3.49	5.96	9.00	5,457.8	+4.0	-28.8	-34.3
Israel	4.23	4.08	5.98	4.05	440.4	+1.0	-11.0	-14.9
South Africa	8.29	7.01	11.7	9.66	8,527.1	-2.1	+2.4	-6.5
Turkey	1,376,500	639,495	1,946,233	66.00	9,577.7	-6.2	+1.5	-50.6
Czech Republic	38.6	38.7	54.6	5.58	358.4	-4.3	-25.1	-27.0
Hungary	282	285	398	11.00	6,577.1	-0.5	-16.2	-16.0
Poland	4.22	4.38	5.96	15.32	12,787.8	-2.8	-28.4	-29.8
Russia	29.4	27.8	41.5	25.00	190.3†	-2.4	+36.1	+32.8
EMF (MSCI)‡	1.00	1.00	1.41	na	303.2	-0.1	na	-9.2
EMBI+§	1.00	1.00	1.41	na	205.6	+4.5	na	+1.8

*Inflation adjusted. †In $ terms. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus.

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